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A SINGLE AUDIT MODEL
for
FEDERAL CREDIT UNIONS

by

Richard Dale Allen

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Thesis Advisor: R. A. Bobulinski

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Administration and key control points to be verified by the internal auditor. A segment of the model is utilized in a management audit of a local cooperative to test its usefulness and flexibility. Conclusions and recommendations are then provided on the case for a "single audit" model as well as testing and evaluation procedures for the model to ensure enhancement of the internal audit functions in Federal credit unions.

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A "Single Audit" Model for Federal Credit Unions

by

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Submitted in partial fulfillment of the
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ABSTRACT

This thesis explains the basic operations of a Federal credit union, describes the role of internal auditing, reviews the internal audit function of cooperatives, and explores the potential benefits of a "single audit" program for credit unions. An auditing model is developed with subprograms to review fiscal administration, property management, procurement, personnel, and the operational activities of a Federal credit union. The model contains preferred practices of the National Credit Union Administration and key control points to be verified by the internal auditor. A segment of the model is utilized in a management audit of a local cooperative to test its usefulness and flexibility. Conclusions and recommendations are then provided on the case for a "single audit" model as well as testing and evaluation procedures for the model to ensure enhancement of the internal audit function in Federal credit unions.

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I. INTRODUCTION

A. GENERAL

Financial intermediaries are operating entities that serve the money and capital markets of a society. These are institutions which function as middlemen between borrowers and lenders. They originate and circulate financial liabilities or obligations against the entity to facilitate the acquisition of profitable financial claims against others. Economists have classified financial intermediaries into two broad categories: "commercial banks and all other financial institutions, including mutual savings banks, savings and loan associations, credit unions, mortgage companies, and so on" [1:223]. Each of these institutions attempts to accommodate particular needs and preferences of clientele groups by operating as a wholesaler or retailer of funds.

As a financial intermediary, the credit union is seen as "an extension of the household" [2:xvii]. Organizations developing from a felt need that ranged from normal financial necessities to economic emergencies [3:1-1]. Further, the entity evolved due to the insatiable appetite that consumers have for the vital commodity known as credit. Thus, many customers have successfully satisfied needed credit requirements in a cooperative manner through the use of a credit union.

Credit unions function as nonprofit cooperative financial intermediaries organized to promote thrift and to accumulate funds from savings to fulfill credit needs of members at reasonable interest rates [3:1-1]. Usually, the entity is formed by individuals who share a common bond - membership in a labor union, church, or fraternal organization; employment in the same organization, profession, or regional area; or service in the same branch of the armed forces. The institution exists to promote the economic interests and social concerns of the membership.

The typical credit union plan provides for regular savings, credit tailored to fit individual needs, and the opportunity for members to assist in the financial management of the organization [3:1-1]. Due to credit unions being member-owned, member-controlled financial entities, the consumer has an important voice in operating, managing, and controlling affairs of the institution. Members are responsible for the election of a board of directors and credit committee at annual proceedings where each member has one vote regardless of the number of shares held.

On December 31, 1979 a preliminary survey revealed approximately 21,750 credit unions in the United States with some 43,466 million members and total assets of more than 65,854 million dollars. Credit unions hold more than 15 percent

of all installment credit outstanding with 53,125 million dollars in loans and 56,232 million dollars in deposits [4:5]. They are well established institutions in the American financial world and are deserving of serious examination.

B. BRIEF HISTORY OF CREDIT UNIONS

The first credit union was established in Germany by Herman Schulz-Delitzsch during the 1840's. The primary objective of this initial entity was to purchase raw materials at wholesale and selling to the membership at cost. Credit was not extended to members for purchases because Schulze-Delitzsch believed that credit cooperatives should be maintained separate from purchase cooperatives. Therefore, to accommodate purchasing members needs for credit, Schulze-Delitzsch organized a cooperative credit society. These separate but similar types of cooperatives formed the initial roots of the credit union movement, and in only 30 years approximately 3,000 cooperative credit societies were organized in Europe [3:1-1].

Friedrick Wilhelm Raiffeisen is regarded as the founder of rural cooperative societies in Germany similar to the urban societies formed by Schulze-Delitzsch. Raiffeisen, interested in the moral character and economic status of rural workers, organized two cooperative societies intended as self-help vehicles for the poor [3:1-1]. These cooperative credit societies, an adaptation of the Schulze-Delitzsch plan, marked the essential beginning of the credit unions of today.

Alphouse Desjardins, a legislative journalist reviewing economic conditions in Europe in the 1900's, learned of the aid rendered consumers through the cooperative credit societies established by Raiffeisen and Schulze-Delitzsch. Desjardins then incorporated this plan with ideals obtained from Luigi Luzzatti, an organizer of cooperative credit in Italy, and Henry W. Wolff, a writer and promoter of the citizen's banks of Europe, in establishing the La Caisse Populaire de Levis. Desjardins extended the principle of self-help by members providing capital and management of the entity. The La Caisse Populaire de Levis is recognized as the first credit union in North America and the organization functions today at Levis in the Province of Quebec, Canada [3:1-1].

The initial support for credit unions in the United States came from Edward A. Fliene, a philanthropic businessman in Boston. Filene through foreign travels had learned of the financial assistance that cooperative credit societies provided the "common man" of Europe and the success of Desjardins' People's Bank of Canada. Thus, in 1909 Desjardins was persuaded by Filene to assist in organizing the first legally chartered cooperative credit society in the United States at Manchester, New Hampshire. This newly established institution was chartered by a special act of the New Hampshire legislature with the primary function of helping consumers of limited means.

Membership of the entity was composed of wage earners in the textile plants of Manchester [3:1-2].

The Massachusetts Credit Union Act, the first complete credit union act in the United States, became law on April 16, 1909. Five cooperative credit societies had been established in Boston prior to the legislation, and because these institutions were serving a worthwhile need, the charters of these institutions were not questioned. Encouraging individual thrift coupled with providing beneficial loans at reasonable rates convinced Filene and the general populus that credit unions were the most economical, efficient, and effective financial intermediaries for the working man [3:1-2].

By 1934, the credit union movement in the United States was well established with 38 states having enacted credit union laws and over 24,000 credit unions serving members. Congressional efforts in legislation for credit unions during this period reached the zenith when the United States Congress enacted the Federal Credit Union Act on June 26, 1934. This Federal legislation provided for the chartering, supervision, and auditing of Federal credit unions by the government of the United States and its territories [3:1-2]. Today the Federal Credit Union Act remains as the primary document governing the operations of credit unions.

C. PHILOSOPHY OF CREDIT UNIONS

Friedrick Wilhelm Raiffeisen instilled the basic philosophy of credit unions in 1920 with the principle of unselfish service [3:1-1]. The credit union movement in the United States commenced on a similar note of high idealism emphasizing service to one's fellowmen. This desire is attributed to the deep religious values that many of the pioneers of cooperative credit societies possessed. According to founders and early promoters, credit unions were established as agencies of humanitarian and philanthropic reform where consumers working together could alleviate problems of obtaining credit [5:354].

Although cooperative credit societies share a common bond, credit unions are not anticapitalistic. In the early stages of development loans were made for productive purposes, for example, to assist small farmers and businessmen to achieve economic independence through the goal of practical cooperation. The central philosophy of the founders of credit unionism was a hope to reduce the sometimes harsh and exploitive aspects of capitalism by making the "system" work better for all consumers. Credit unionism emphasized the importance of democratic control and stressed the importance of participation by all members. Thus, one of the goals was economic democracy through self-help [5:354].

Cooperative credit societies were basically a conservative people-oriented force in American society.

Initially credit unions utilized numerous volunteers as organizers, operators, and managers. However, as early as the 1920's the need for professional individuals to manage and operate the entities was realized [5:356].

Today credit unions function as financial intermediaries, encouraging members to utilize share accounts to accumulate savings from their income as a means of establishing economic security for themselves and their families. Credit unions provide loans to members for the purchase of homes, cars, and to pay medical bills as well as other worthwhile purposes. Through these practices credit unions help members to help themselves to a greater degree of financial stability and independence.

Today credit unions strive to recruit individuals who are eligible for membership. Saving and loan programs are then constructed to fulfill the needs of the consumer. Credit unions also strive to provide fair interest rates on savings. reasonable rates on loans, and convenient services to members, including financial counseling [3:2-1].

Thus, the cooperative pooling of savings and the lending of funds remain the same today as in the initial cooperative credit societies in Germany formed by Friedrick Raiffeisen. In addition, "the principles of self-help, cooperation, and democracy still rank high in the traditions and practices of credit unions" [5:357].

D. PROBLEMS, OBJECTIVES, AND SCOPE

In a Research Report published by the National Credit Union Administration (NCUA) in July 1969, entitled Credit Unions and "Tight" Money, reasons were discussed for the then-prevailing "tight" money situation characterized by rising operational expenses, growth of money market funds in other intermediary, and the reduction in the supply of funds available to meet members' credit needs. The report suggested that it was "time to eliminate all costly, nonessential activities" and thereby reduce a portion of the increasing operational costs. Today credit unions are again faced with the problems of a changing economy resulting from high inflation and increasing operational costs. However, Federal credit unions do have a potential "tool" that can assist management in "eliminating costly, nonessential activities." This "tool" is the internal auditing process.

The purpose of this research study, therefore, is to examine, evaluate, and draw supportable conclusions on the operational review process utilized in Federal credit unions. To obtain this objective, the current effectiveness of the supervisory committee, as an internal audit body for Federal credit unions, is assessed through the use of a survey questionnaire. Further, the potential benefit of developing a "single audit" program to audit preferred operational and

fiscal practices of cooperatives similar to the audit guide developed to audit Federal grants by the Government Accounting Office (GAO) is explored.

The scope of this study includes internal auditing in Federal credit unions in the Continental United States. Federal credit unions that operate in the Monterey Peninsula, San Francisco, and San Diego areas of California were randomly sampled for the research completed in this study. The internal auditing process addressed by this thesis includes guidance issued from NCUA and by experts in the field of auditing. State credit unions are excluded from consideration in this study due to the resource constraints of the author.

E. METHODOLOGY

In this study, NCUA and National Association of Federal Credit Union publications and directives applicable to Federal credit unions were reviewed. In addition, other professional literature on preferred practices and operational practices of Federal credit unions were examined.

The First part of this study discusses the organizational structure, policies, and procedures utilized to conduct operations of Federal credit unions. Further, the primary role of an internal audit body is explained as well as the nature, benefits, and scope of internal audits.

The second part of this thesis then evaluates the supervisory committee from the general managers perspective

to determine if it is in fact an active internal auditing entity for Federal credit unions. Further, the perceived need by general managers of Federal credit unions for a "single audit' program to review key operational areas in cooperatives is also evaluated. The mechanism utilized to conduct these evaluations is a survey questionnaire shown in Appendix A. A "single audit" program is then developed to audit preferred operational and fiscal practices of Federal credit unions. The personnel section is then used to analyze a local cooperative and assess the program's usefulness. Conclusions are then provided as a point of reference to improve internal auditing within the Federal credit union hierarchy.

F. THESIS ORGANIZATION

Chapter II presents the organizational structure, services provided, and management operations of a Federal credit union. Preferred practices are explained in detail by discussing information contained in NCUA and National Association of Federal Credit Union publications and directives. Information published in other sources that deal with preferred Federal credit union practices are also discussed. Further, the role of the supervisory committee as the internal auditing body for the cooperative is explained. This chapter is provided in order to put all readers on a common plane in regard to credit unions.

Chapter III explains the primary purpose of an internal audit body, such as the supervisory committee in a cooperative, and discusses the nature, benefits, and scope of internal audits. The chapter also relates the role of internal auditing in appraising the performance of management and the basic knowledge an internal auditor must possess. The last section of this chapter explains the new "single audit" concept of auditing and its potential for application to Federal credit unions.

Chapter IV is the presentation of an overview and description of the results of a questionnaire concerning the internal and external auditing of Federal credit unions. The auditing questionnaire shown in Appendix A is the basis for this chapter. Questions contained in the survey endeavor to solicit information concerning audits performed, auditors involved, and audit programs, objectives, or audit guides for audit tasks. Additionally, the questionnaire attempts to evaluate the perceived need by general managers of Federal credit unions for a "single audit" program. The results of the survey as well as the questions themselves are explained. Additionally, the survey scope, organizations surveyed, and the survey methodology is discussed.

Chapter V develops a "single audit" program for Federal credit unions. This guide is for use in auditing preferred practices explained in Chapter II. Its basic purpose is to

reduce the number of audits required and to expand the audit coverage of the supervisory committee to include all preferred practices for Federal credit unions.

Chapter VI represents the final analytical chapter of this project. The personnel audit guide developed as a section of the "single audit" program in Chapter V is utilized to perform a management audit of a Federal credit union. The chapter explains the audit objective for the review, the preliminary survey conducted, the detailed examination performed, and the findings and recommendations of the audit.

Chapter VII presents the conclusions and recommendations developed from the research study on the need for a "single audit" program to enhance the internal auditing of Federal credit unions.

II. STRUCTURE, SERVICES, AND OPERATIONS OF FEDERAL CREDIT UNIONS

A. INTRODUCTION

This chapter discusses the organizational structure, services provided, and management operations of a typical Federal credit union. It is designed to provide the basic background and general information necessary for the reader's understanding of material presented in subsequent chapters of this study.

B. ORGANIZATION

Numerous factors contribute in shaping and molding an operating entity. These factors range from improved technology and increased management education to changing attitudes and Congressional legislation [6:367].

This section discusses the principle government body for Federal credit unions, charters for Federal credit unions, and explains the organizational structure of Federal credit unions.

1. National Credit Union Administration (NCUA)

The Federal Credit Union Act enacted on June 26, 1934 provided for the chartering, supervision, auditing, and insuring of all Federal credit unions. On March 19, 1970 Public Law 81-206 amended the 1934 legislation and established the NCUA as the principle governing entity for Federal credit

unions [7:1]. NCUA functions as an independent agency vested in the executive branch of the Federal Government. Federal credit unions although not considered as independent government agencies are regarded as instrumentalities of the government [3:2-1].

Management of NCUA is administered through the National Credit Union Administration Board (NCUAB). The NCUAB consists of three members appointed by the President. Additionally, the President designates one member to serve as chairman. All members of the Board have staggered six year terms to preserve continuity [8:2].

Congress conducts the "over-sight" task for all financial programs implemented and approved by the Board. Further, the General Accounting Office (GAO) is responsible for annual performance audits of NCUA and reporting the findings to Congress [8:2].

2. Charters

All charters to form a Federal credit union must be reviewed and approved by the NCUA. Application for a charter requires that at least seven but not more than ten individuals be selected as subscribers. "The subscribers must be from, and representative of, the group constituting the field of membership." Subscribers then are required to select at least five qualified proposed members who will agree to serve on the credit union's board of directors, three qualified proposed members who will agree to serve on the credit committee, and

three qualified proposed members who will agree to serve on the supervisory committee [9:701-1].

An application for the charter is then forwarded to NCUA which must include:

a. the name of the proposed entity;

b. the geographical location of the proposed institution and the territory to which operations will be confined;

c. the names and addresses of subscribers and number of proposed shares to be purchased by the subscribers;

d. the par value of all proposed shares, stipulated to be five dollars each;

e. the proposed field of membership for the entity;

f. the term of the existence of the institution, which may be perpetual; and

g. the fact that the application for the charter is made to help individuals help themselves [9:701-1].

NCUA's philosophy in chartering of Federal credit unions is much more than simple availability to savings and credit facilities; membership is ownership and presents the opportunity for each qualified member to participate in establishing policy and management of the entity [3:1-1]. NCUA fully supports the goal of developing and maintaining sound organizational services for as many members as possible within the limits established by the Federal Credit Union Act [3:1-1].

NCUA has developed recommended minimum potential membership guidelines for approving a charter by fields of

membership. These types of groups and minimum potential membership quantities are reflected in Exhibit II-1 [3:2-1].

Further, prior to approval of a charter the NCUA is required to investigate each application to ascertain conformity with the Federal Credit Union Act, "the general character and fitness of subscribers, and the economic advisability of establishing the proposed Federal credit union" [3:2-1].

3. Membership

Membership in a Federal credit union is limited by the Federal Credit Union Act to groups of individuals who possess a common bond in profession of association or well-defined geographical location [8:6].

To become a qualified member or to be eligible for membership, the individual must purchase a minimum of one share of stock. Additionally, the joining member may be required to pay an initial entrance fee for membership as stipulated by the credit union's board of directors [8:6].

Shares purchased may be jointly owned with the right of survivorship. Further, any individual desired by the purchasing member is eligible for joint ownership. However, individuals so designated as joint owners of shares do not vote, become eligible for loans, or hold entity office unless those individuals are in the specific field of membership and are qualified members of the credit union [8:6].

EXHIBIT II-1

GROUPS AND MINIMUM POTENTIAL MEMBERSHIP QUOTAS

Type of Group	Minimum Potential Membership
Occupational	200 employees
Associational:	
Labor Unions	300 members
Fraternal, Professional and trade Associations	300 members
Religious	300 families
Cooperative	300 members
Community	1,000 population

Individuals who become members of a Federal credit union are expected to take an active interest in the institution. They are responsible for the election, from the membership, of individuals to serve as management officials on the board of directors or credit committee. Members are further tasked with maintaining a dynamic interest in democratic control of the entity by attending and participating in member meetings for the purpose of electing management officials. The membership is expected to promote the growth of the cooperative by informing friends and neighbors within the specified field of membership of services offered and benefits derived from the credit union. In addition, members are expected to repay loans on time as stipulated in the loan agreements and to maintain a sound credit rating [7:5].

Membership in a Federal credit union is not static. Members do have power which they can exercise to maintain control and direction of the cooperative. For example, the membership can remove or suspend any official for cause and may expell members from the credit union with approval of two-thirds vote of the membership. Further, the membership may in fact initiate action against any employee of the credit union or member considered as not serving the best interests of the membership [7:5].

4. Board of Directors

The board of directors is composed of individuals from the membership who are qualified members of the Federal

credit union. Members of the board are elected at annual meetings and serve on the board of directors for either two or three years as stipulated by the board. Each board of directors for a Federal credit union must consist of not less than five members; however, the maximum number of board members can vary according to the Federal Credit Union Act [7:9].

Directors are tasked with the responsibility for business affairs of the cooperative to include general direction and overall control of the credit union [7:9]. To assist the board in meeting its responsibilities, the board may delegate tasks and form committees as authorized by the Federal Credit Union Act. For example, the board may establish a membership committee to review pending membership applications or an investment committee to make investments for the entity [7:15]. A supervisory committee is required to be appointed be the board of directors to serve as the internal audit body [7:9].

If a vacancy occurs on the board of directors due to death, resignation or removal, the directors have the authority to fill the vacancy with a majority vote of the board. However, newly appointed directors maintain office only until the next annual meeting where the vacancy must be filled through the election process [7:9].

The directors are authorized to determine interest rates on loans, maximum amounts of loans or line of credits, and the investment policy of the institution [8:7]. They

implement or ensure the implementation of all policies and procedures approved by the board, membership, credit committee or supervisory committee. In addition, the board establishes and approves all operating and management policies [7:4].

5. Supervisory Committee

Members of the supervisory committee are appointed by the board of directors of the Federal credit union and serve as the cooperative's internal audit body [7:9]. The committee is composed of not less than three members nor more than five [8:6]. They are tasked to perform annual audits and to verify each members share and loan balances at least once every two years [7:4].

The supervisory committee may, by unanimous vote suspend any officer of the cooperative or any member of the credit committee or board of directors until the next members' meeting. However, this meeting must be scheduled by the committee not less than seven nor more than 14 days after the suspension [8:8]. Then the suspension must be resolved by the membership.

To provide a check on the powers of the supervisory committee, the Federal Credit Union Act stipulates that, any member of the committee may be suspended from office by a majority vote of the board of directors [8:8].

6. Credit Committee

The credit committee must consist of not less than three nor more than seven qualified members of the cooperative

elected to the committee at annual election proceedings [10:1]. The principle task of the committee is meeting monthly to consider applications for loans and lines of credit. Approval of an application requires a majority vote of the credit committee. To assist the committee, they have the authority to appoint loan officers and delegate the power to approve loans and lines of credit. However, appointed loan officers are required to furnish a record of all applications approved and disapproved to the committee within seven days of the date the loan application was filed. Further, all applications not approved by loan officers must be acted on by the credit committee [8:7].

To ensure separation of duties, no Federal credit union employee has the authority to disburse funds on applications for loans or lines of credit approved by that individual [8:7]

The credit committee is further responsible for determining if loans to members are for legal purposes and ascertaining each applicant's qualification for loans. They also counsel members on the wise use of credit and act on requests from members for extensions and refinancing of loans [7:4].

If vacancies occur on the credit committee, the board of directors has the authority to fill such vacancies until the next scheduled annual members' meeting [10:1].

In conclusion, the board of directors, credit and supervisory committees comprise the basic organizational

structure of a cooperative [7:9]. However, no member of this organizational structure may receive compensation for his/her official duties within the credit union other than health, accident, and similar insurance protection [9:701-25].

C. COMMITTEES

The Federal Credut Union Act provides for the establishment of other than credit and supervisory committees to assist the board of directors in maintaining overall control and direction of the credit union. If additional committees are formed, at least one director from the board is usually assigned to serve on each committee. Further, the director so assigned, may be designated the chairman of the additional committee by the board of directors [7:17].

1. Executive Committee

The executive committee serves at the pleasure of the board of directors and is composed of not fewer than three members. It may function for the board in specific areas of responsibility designated by the Federal Credit Union Act and NCUA Rules and Regulations. For example, the committee may be responsible for selling securities, approving loans to other cooperatives, or borrowing capital and authorizing repayments.

The executive committee is often tasked with the responsibility to implement the board of directors budget and personnel policies [7:17].

2. Budget Committee

The board of directors has the authority to designate a budget committee to assist the board in maintaining control over the cooperative's budget [7:17]. A dedicated budget committee can assist management in formulation and execution of the budget.

The Board of Directors Manual for Federal Credit Unions recommends that a cooperative's budget be flexible, consider growth trends, cash needs, and project income and expenses. Further, the budget must not be a static tool, adjustments must be made to attain the strategic plans and objectives established by the board of directors. Therefore, a budget committee can contribute to the careful planning and continual attention required to enhance budget management and control operational expenses [7:17].

3. Personnel Committee

If a credit union has numerous employees, the board of directors normally appoints a committee to assist in formulation and administration of equitable personnel policies. The primary tasks of the personnel committee are ensuring that the cooperative has competitive salary scales, adequate fringe benefits, pleasant working conditions, and acceptable promotional opportunities. Further, the committee should have a vital role in developing formal and informal training programs to ensure that all employees are qualified to perform the tasks necessary to serve the best interests of the cooperative [7:17].

4. Delinquent Loan Committee

The board of directors can establish a delinquent loan committee to assist in overseeing or supervising day-to-day loan collection programs. Further, the committee is often granted the authority to take positive corrective action to effectively collect delinquent loans from members who do not respond to regular collection efforts [7:17].

5. Education Committee

This committee, also designated by the board of directors, is responsible for informing potential members of credit union benefits and encouraging potential members to join the cooperative. They explain various services provided by the entity and conduct membership "drives" to increase the cooperative base. Additionally, the education committee is normally the focal point for all public affairs and projects the public image of the credit union [7:18].

D. MEMBERSHIP SERVICES

This section of the study discusses the various separate accounts available to members of Federal credit unions and explains services provided by the cooperative.

1. Share Accounts

Share accounts, or regular share accounts, represent the regular form of savings for members of a Federal credit union [11:6]. They are analogous to the passbooks of commercial banks or saving and loan associations [11:6]. However,

Federal credit unions do not issue passbooks to members for funds deposited in share accounts. Members receive either monthly or quarterly share account statements that reflect transactions conducted during the reporting period and the ending account balance. Further, the monthly of quarterly balance of the account does not display the number of shares owned by the member, but total funds invested in the share account.

Share accounts are the most convenient method for members of a cooperative to save because normally there exists no requirement as to the minimum amount that can be deposited. Further, the account does not require the member to maintain a balance greater than the five dollar par value of a share or to give the entity notice of intent to withdraw funds, except as may be imposed by Federal Credit Union Bylaws [9:701-27]. Members receive dividends on funds invested in the share accounts usually compounded quarterly and posted to individual accounts.

2. Share Draft Accounts

Share draft accounts are regular accounts that Federal credit unions agree to honor for withdrawal of shares [9:701-26]. They are equivalent to commercial banks' or saving and loan associations' interest-on-checking accounts [10:4].

Members are encouraged to participate in share draft accounts because no service charge for cashing checks is levied and the account pays an annual dividend, normally

compounded quarterly. To facilitate reconciliation of a share draft account, monthly statements that indicate the amount, number, and date cleared of each draft are forwarded to members. Paid share drafts are not incorporated in the monthly statements, but are maintained by the cooperative [12:5].

To operate a share draft account program in a Federal credit union, the entity must submit a request to the National Credit Union Administration (NCUA) at least 60 days prior to the proposed date to implement the program. The cooperative cannot commence operations of the program until written approval is received from NCUA. NCUA has the authority to limit the number of credit union members that can participate in a newly established share draft program for one year [9:701-26].

Share draft accounts are separate accounts and normally are not combined with share accounts. However, they provide an additional incentive to members by not requiring a minimum balance to qualify for annual dividend payments.

3. Share Certificate Accounts

A share certificate account is one that earns dividends at a predetermined rate for a designated period of time [9:701-27]. These accounts are for serious members who desire a greater return on their investments. For example, a member can deposit 5,000 dollars for six months and will receive a higher dividend rate than that paid on a share account. Share

certificate accounts are similar to certificates of deposits at commercial banks or saving and loan associations.

If the member withdraws funds from the share certificate account prior to the designated maturity date of the account, a minimum of 90 days notice is required and the member is assessed a penalty on dividends earned for not meeting the terms of the original agreement [9:701-28].

Written contracts govern additions to share certificates. The contract may stipulate that deposits to the account prior to the maturity date reset the entire account for a period of time equal to the original time period, or that regular additions to the account can be made for the duration of the contract without resetting the original maturity date [9:701-28].

Maturity periods cannot be less than 90 days nor more than six years. However, upon maturity of a share certificate it can be automatically renewed with the same terms and conditions as stipulated in the initial contract or a revised contract can be established between the member and the cooperative [9:701-28].

The NCUA requires that dividends earned on share certificates must be at least equal to the current rate paid on regular share accounts [9:701-28].

4. Trust Accounts

A Federal credit union may act as a trustee or custodian of funds for members or groups or organizations of

the membership. In addition, the cooperative may receive reasonable compensation for this function under any trust instrument or custodial agreement created. The funds held in trust accounts are required to be invested in share accounts or share certificate accounts of the credit union [9:721-3].

Revocable or irrevocable trust accounts may be provided by Federal credit unions. The informal, revocable trust, can be cancelled at any time by the qualified member, who maintains full rights of ownership. Irrevocable trust accounts are legally binding on the member. This account cannot be cancelled at the will of the member and can only be established if the individuals involved have a trust instrument prepared by an attorney [12:6].

5. Loan Protection Insurance

Many Federal credit unions provide loan protection insurance for members without extra charge. With this service a qualified member's life is insured for the amount of funds loaned, up to a contract limit, usually 10,000 dollars. Further, qualified members loan balances may be paid in full if they become totally or permanently disabled [13:2].

6. Life Savings Insurance

Life savings insurance is provided by many Federal credit unions as an additional inducement for thrift. This program insures each eligible member, depending upon age, up to 100 percent of a maximum insurable balance, usually stipulated to be 2,000 dollars. The program is supplied to qualified members without assessment [13:2].

7. Individual Retirement Accounts

An individual retirement account is a specialized account that cooperatives offer to qualified members of the credit union. The account is designed to provide retirement income for individuals who are self-employed or who do not have a regular retirement plan offered by their employer. Individual retirement accounts earn higher dividend rates than regular share accounts; however, the funds deposited must remain in the account unless transferred to another type of retirement account. If the funds deposited are withdrawn the Internal Revenue Service then penalizes the member [12:8].

Dividends earned on the account are not recognized as income for Federal income tax purposes in the period earned, but taxes must be paid on the dividends when the account is closed or upon retirement [12:8].

8. Additional Services

Many additional services are provided by many Federal credit unions to include: safety deposit boxes, creditor's disability insurance, traveler's checks and money orders, consumer education, and financial counseling [13:2].

Each service offered by Federal credit unions attempt to promote thrift and regular savings among members to attain a higher level of economic security.

E. OPERATIONS

This section of the research study discusses the various policies and procedures utilized to operate Federal credit

unions. Preferred practices and internal controls necessary to ensure effective and economical operations are also explained.

1. Policies and Procedures

The board of directors is responsible for establishing policies of the cooperative. Policies constructed which are carefully designed and realistic, enable the entity to conduct operations in a manner that best serve the interests and social concerns of the organization as well as the membership [7:18]. Comprehensive policy statements give direction and instruction, thus avoiding uncertainty and ambiguity.

Effective policymaking cannot become a fragmented activity occasionally practiced by the cooperative's board of directors. It must be a continual task whereby the directors establish a review system to ascertain if policies and practices are being carried out. Further, policies must be adjusted periodically to realize maximum value and benefit to the entity [7:18].

Policy statements from the directors normally encompass broad objectives and may relate general direction in accomplishing such objectives [7:18]. However, they may also be narrow in scope and restrictive in application to serve the best interests of the membership.

Policies established by the directors that effectively direct and manage the functions of the cooperative are characterized to be: "firm and clear in purpose and implementation, consistent with the credit union's objectives, in

compliance with the Federal Credit Union Act, in accordance with the needs of the membership, and consistent with sound business practices" [7:18].

A preferred practice for maintaining policy statements established by the board of directors is to construct a policy control record in the minutes book of the board. Further, if new policies are established, a written policy statement should be forwarded to all employees, members, groups, or committees affected by the policy [7:18].

After establishment of policy statements, procedures for implementation must be determined to achieve the stated purpose of the policy. Procedures such as detailed practices or plans to carry out policy statements are paramount. The statement of objectives, plan of organization, and the established policies or procedures to accomplish the objectives are closely linked and cannot be effective if the linkage is not maintained [7:18].

The implementation and initiation of policy statements are vested in the board of directors. To enhance the implementation process, board members must determine accountability for carrying out policy and stipulate the expected results to be achieved. Additionally, policy statements should incorporate a periodic reporting or feedback system for evaluation and program changes needed to accomplish the intended results. Further, coordination of efforts must exist among the accountable party, the board of directors, and the overall entity

to accent a smooth adoption of the new or revised policy into the objectives of the cooperative [7:19].

Program management of policies and procedures to achieve expected results is improved through good management techniques in the areas of planning, organizing, and controlling the activities of a cooperative [7:19].

Thus, since planning encompasses the systematic arrangement of all factors required to accomplish stated goals and objectives, the board of directors is confronted with the necessity to perform a detailed analysis of all proposed policies. This analysis should include identification of the specific objective of the policy [7:19]. For example, the board of directors vote to establish a "recruiting program." The program objective is determined to be increasing the membership of the cooperative by 20 percent in the next calender year.

Another aspect of the analysis should give consideration to determining the basic purpose of the program [7:19]. For example, the purpose of the "recruiting program" is to expand the membership base and increase community knowledge of services provided by the cooperative.

Commencement and termination dates of the program should be evaluated in the analysis [7:19]. For example, the program will commence on the first day of the second quarter and terminate on the first day of the third quarter.

Accountability should be established for implementating the policy and expected results should be defined [7:19]. For example, the directors may either appoint an individual or a committee to be responsible for the program and stipulate that success will be measured by the increase of members in the second quarter.

Final points that the analysis should address include: the scope of the program, materials and resources required, funds necessary, and any requirement for advertising or publicity [7:19].

To ensure effective and economical use of resources upon completion of the analysis, the board of directors should establish a plan of organization to accomplish the stated objectives of the program. The plan must mobilize and organize the staff or members who are required to implement the program. An effective plan of organization will motivate, delegate, and provide general direction. Further, directors must ensure that individuals involved in the program are familiar with their specific role and responsibility in accomplishing the program's objective. Additionally, the directors must inform members, groups, and committees of the program's status and results achieved. Information on programs can be distributed by oral reports at meetings or by written reports to the membership [7:19].

Control represents the final management tool that the directors must have to readily ascertain if program plans

are being accomplished in regard to established policies and procedures. With the development of a review system, prompt action can be taken to prevent unsatisfactory performance in either the conduct of the cooperatives daily affairs or in achieving expected results from new programs [7:19].

Effective review systems identify unauthorized actions that hinder both growth and operations of the entity. They maintain liaison with the membership on the cooperative's growth and aid in predicting trends to forecast results. Reliable systems provide information for evaluating performance, considering new proposed programs, and assessing the effectiveness of present programs [7:19].

2. Administrative Management Policies

Administrative management policies provide internal checks necessary for the operation of the cooperative's normal daily routine. Effective policies aid in detecting and preventing illegal or unauthorized acts [7:20].

The Federal Credit Union Act requires that certain internal controls be incorporated in all Federal credit unions. For example, cooperatives are required to issued either passbooks or account statements for all deposits received. Further, all loan agreements must be signed by members as evidence that funds were borrowed. "The Act and bylaws also prescribe the authority and responsibilities of officers, directors, and official committee members" [7:20].

However, establishing and maintaining effective internal controls in a Federal credit union are the responsibility of its board of directors.

To successfully accomplish this task the directors should mold the cooperative's operating procedures by ensuring the separation of duties, establishing a central control point for verification of work, and "providing physical and mechanical facilities that support the maximum level of accuracy and work output." The supervisory committee should, as the internal auditing body, review and evaluate all internal controls at least annually. Weaknesses or deficiencies found should be reported to the board of directors and the committee should conduct follow-up investigations to determine that corrective action is taken [7:20].

Internal controls assure the maximum levels of service, growth, and protection to the membership. Therefore, the board of directors must establish controls in the areas of organization, budgeting, accounting, and operational procedures utilized by the cooperative, Controls should be constructed for cash receipts and cash on hand, disbursements, maintenance of accounts and records, loan delinquency, loans charged-off, investments, security devices and procedures, personnel, membership, supervisory committee audits, etc [7:20].

3. Financial Management Policies

Effective financial management policies are the result of a good planning process. Specifically, financial planning

facilitates an analysis and projection of proper utilization of resources to maintain a sound financial base and aids in identifying services required for saving, borrowing, and financial counseling of members [7:21].

To guide the board of directors in making fiscal policy for the cooperative, an overall plan should be developed from an evaluation of prior financial conditions, trends, and projections. The major source of information available to assist directors is the financial and statistical reports of the entity. These reports present the results from previous operating policies and trends on both monthly and annual base. They provide valuable data for analyzing past and future financial environments that may confront the organization [7:22].

Data that can be reviewed are current financial conditions including cash available, reserves, and the amounts encumbered by delinquent loans [7:22]. Further, trends of previous financial conditions, savings, and borrowing of members can be evaluated as they effect the entity.

Complete and effective financial plans recognize current financial conditions of the cooperative, changes over previous years, and the projected state of the economy [7:22].

4. Personnel Policies

The board of directors is responsible for establishing basic personnel policies for recruiting, selecting, training, and supervising employees. Personnel policies established

should define performance standards and assign specific duties. Realistic and effective personnel policies give consideration to compensation, promotion, vacation, sick leave, retirement, and other benefits to attract and retain qualified personnel. Further, to remain competitive policies constructed by the directors should be periodically reviewed and evaluated as the cooperative grows. Progressive personnel policies enhance recruiting, training, and retention of qualified competent employees [7:42].

If a cooperative has numerous employees, the board of directors normally delegates the responsibility for personnel policies to a personnel committee or to the manager of the cooperative. However, the directors should have job descriptions prepared that define the employees' responsibility, identify the supervisors, and list the required performance standards. Once job descriptions have been prepared, the directors often set the job qualifications along with expected compensation to be paid. Realistic salary and wage policies must recognize the "going rate" for similar duties in the local area. Fringe benefits available to employees must also be considered by the board of directors. Therefore, the board must consider the various life, health, accident, and retirement benefits that will be suitable to employees and then construct viable personnel policies [7:42].

Personnel policies established by the board of directors should not remain static. They required long-range

planning and must be coupled with the cooperatives' managerial and financial objectives [7:42].

5. Loan Policies

To assist members in the wise use of credit, the board of directors must establish practical and realistic loan policies [7:26]. Sound loan policies are of vital importance for a cooperative to achieve and sustain its basic objective.

Established loan policies should be tailored to the needs of both the membership and the cooperative. For example, policies should consider: the cooperative's capital and facilities, capabilities and experience of employees, local and national economic conditions, and the needs, character, and repayment capabilities of each borrowing member. Loan policies should also be coupled with long-range financial objectives and practices of the entity [7:26].

The Federal Credit Union Act requires the credit committee to act on loan applications from the membership. However, the board of directors are required to act on loan applications from members of the board of directors, supervisory committee, and the credit committee. Decisions on loan applications made by the credit committee are final and cannot be overruled by the board of directors. However, the credit committee does not have the authority to approve any loan or to delegate authority to loan officers in violation of loan policies established by the board of directors [7:26].

As the credit committee should apply the three "C's" of - Character, Capacity, and Collateral - when acting on a members loan application, the board of directors in establishing loan policies should consider the cooperatives current financial condition current and expected economic conditions the entity's prior loan experiences the basic principles for granting sound credit and requirements placed on the organization by the Federal Credit Union Act [7:27].

The Federal Credit Union Act does establish certain loan policies to guide the board of directors which cannot be legally violated. For example, the maximum loan limit for an unsecured loan from a cooperative with unimpaired capital and surplus of 100,000 dollars is 2,500 dollars on a members signature. Additionally, the loan limit for a secured loan from a cooperative with more than 2,000 dollars in unimpaired capital and surplus is ten percent of that total to any one individual [7:27].

Interest rates for loans represent a primary consideration in any loan policy established by the board of directors. The board should ascertain what interest rate conforms to the cooperative's overall financial objective and strive to ensure that shareholders and borrowers are treated equitably [7:27].

The board of directors do have the authority to establish different interest rates for each type of loan. However, variations from a uniform rate must be based on standards equitable to all members [7:27].

In determining interest rates on loans the Federal Credit Union Act provides some guidance to the board of directors. The present interest rate ceiling is 21 percent and the cooperative cannot legally charge a rate that exceeds this maximum. However, once the directors have established interest rates for the cooperative, they should review these rates frequently to remain competitive.

6. Loan Collection Policies

An aggressive loan collection policy should be established and enforced by the board of directors. Members thereby learn to honor their obligations and those of the credit union. Lack of an aggressive policy contributes to untimely payments, carelessness, disrespect for incurred obligations, and can seriously effect the sound financial base of a cooperative. The effectiveness of an aggressive collection policy has a direct relationship to cash inflows experienced by the entity. Deliquencies and untimely loan payments decrease cash receipts and impede the normal cash flow planning of the cooperative [7:28].

To establish an aggressive collection policy all loan payments not made on time should be followed-up within five to ten days after the member misses the first payment. Further, loan payments should not be excused or extensions granted until adequate explanations have been presented by the member for failing to make the payment. Additionally, all possible legal steps should be utilized to regain funds that members do not intend to repay [7:28].

To assist the board of directors in loan collections, the board often delegates its responsibility to a delinquent loan committee. However, the delegated authority does not relieve the directors of the ultimate responsibility to enforce or adjust, as needed, the loan collection policy. If a delinquent loan committee is formed, the board of directors should require monthly reports to evaluate the effectiveness of the established policies [7:28].

7. Investment Policies

Investments made with the cooperative's funds are the responsibility of the board of directors. When adopting an investment policy due consideration should be made to the overall financial objectives of the credit union and requirements for liquidity, safety, and yield [7:29].

An investment policy established should address both short-term and long-term investment possibilities. Accurate cash budgeting techniques may reveal funds "on-hand" over and above the cash needed in daily operations. Thus, the board of directors should aggressively seek liquid short-term investments. If cash budgeting indicates that excess funds are being generated on a constant basis, then long-term investments with longer maturities might be considered. However, long-term investments should receive careful consideration due to the risks of rapidly changing money markets [7:29].

The Federal Credit Union Act authorizes the board to delegate the responsibilities for investing the cooperative's excess funds. However, if an executive committee is established to conduct the investment policies of the entity the board is not relieved of its responsibility to establish and control investment policy [7:29].

An executive committee should be given definitive policy statements and clear-cut practices by the board of directors. Further, the board shoud specifically state 1. what investments should be approved, 2. when the investments should be made, and 3. when the investments should be sold [7:30].

Prior to authorizing any type of investment the board of directors should determine the compatibility of the investment with the overall financial objectives of the cooperative, the safety and probability of full recovery of the investment, and the liquidity of the investment. Additionally, a sacrifice of safety and liquidity for a higher yield on the investment should be approached with caution. Finally, diversified investments should be made to provide a balance of safety, liquidity, and income from the members' assets [7:30].

The Federal Credit Union Act restricts investments of Federal credit unions to United States Government securities and other instruments issued by the Government, loans to other credit unions, shares or accounts of federally insured saving and loan associations or mutual savings banks, and shares or deposits in central credit unions and federally insured credit unions [7:2].

Federal credit unions are not authorized to invest in non-guaranteed shares of a company which in turn invests in Government securities. Further, investments in United States Government securities through mutual funds are not authorized [7:2].

8. <u>National Credit Union Share Insurance Program</u>

Public Law 91-468, enacted on October 19, 1970 established a Federal program of share insurance for Federal credit unions. This program provides members of cooperatives the same Federal insurance protection on share accounts that other consumers enjoy on deposits in commercial banks or saving and loan associations. [7:45]. All Federal credit unions are insured by the program upon approval of the cooperative's charter.

The share insurance program was not established as a result of heavy losses to member savings. For example, charge-offs for uncollectible loans since 1934 have been less than one-half of one percent. The primary purpose of the insurance program was to secure the future of credit unions and to place cooperative shareholdings on a par with funds deposited in other financial intermediaries. The program has enabled cooperatives to be more competitive as financial intermediaries and attract more saving deposits [7:45].

Federal credit unions are required to pay an annual insurance premium to remain active in the share insurance program. The premium is based upon the amount of member shareholdings at the conclusion of the preceding year of

operations. One-twelfth of one percent of the computed shareholdings is to be paid to the revolving fund on January 31 of each year [7:45].

Maximum insurance coverage provided by the program for a members account is stipulated to be 100,000 dollars. However, with the establishment of various separate share accounts it is possible for a member to have substantially more than 100,000 dollars in insured savings in one cooperative. For example, a member's single ownership share account is insured; a member's joint share account is insured; and an irrevocable trust account is insured. Thus, if each of these separate accounts have 100,000 dollars deposited, total insured funds would be 300,000 dollars.

9. <u>Regular Reserves</u>

At the conclusion of each accounting period the gross income of the cooperative determines the monies required to be set aside as a regular reserve. The primary purpose of the regular reserve is to create a "cushion" against losses on loans and against other losses that the credit union may incur [8:8].

Requirements for the amount of funds to be placed in a regular reserve are governed by the period of time that the cooperative has been in operation and its asset base. For example, a cooperative in operation for more than four years and assets of 50,000 dollars or more is required to maintain a regular reserve of ten percent of gross income until the

reserve equals four percent of the total outstanding loans and risk assets. Then the cooperative must place five percent of the gross income in the regular until six percent of the total outstanding loans and risk assets are covered by the reserve account [8:8]. Exhibit II-2 presents a graphic illustration of regular reserve requirements.

The National Credit Union Administration Board has the authority to decrease the reserve requirement if it considers a decrease necessary or desirable. Further, it may require special reserves to protect the interests of members either by regulation or for an individual cooperative in any special case [8:8].

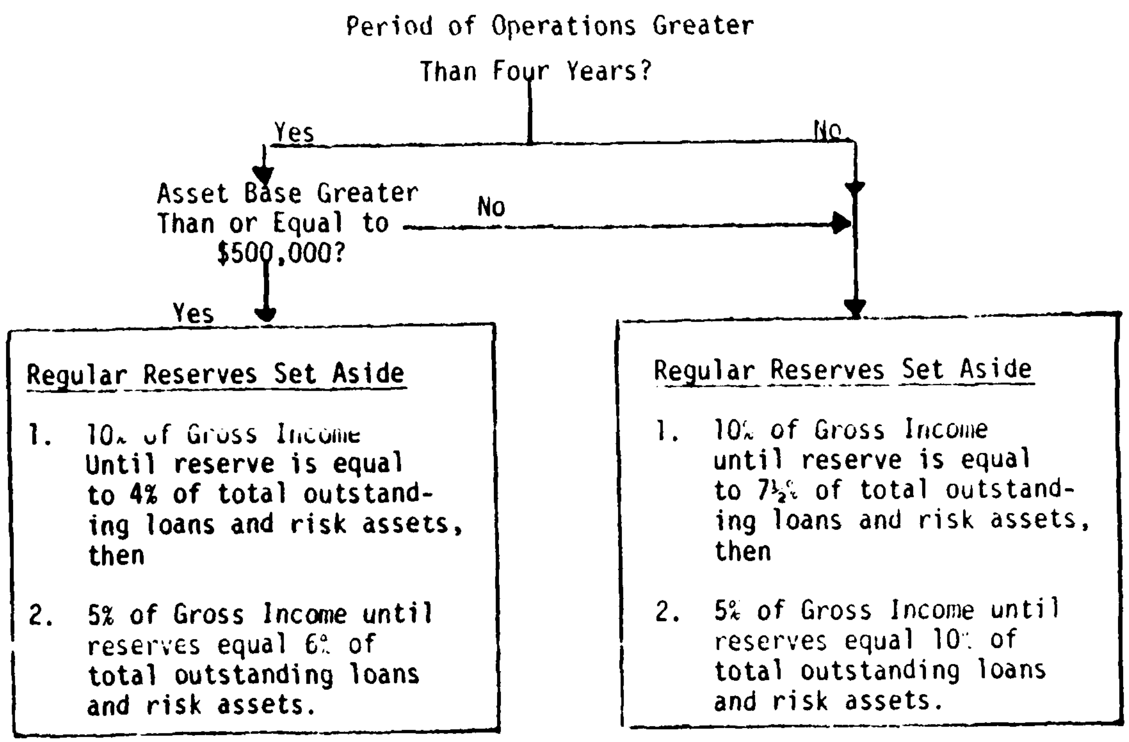
10. <u>Liquidity Reserve</u>

A liquidity reserve is required of all Federal credit unions insured by the National Credit Union Share Insurance Fund, if they have assets of greater than two million dollars or operate a share draft program. The primary purpose of a liquidity reserve is to enhance the ability of the cooperative to meet membership demands for liquid funds and to avoid asset losses to the credit union [9:742-1].

Each cooperative required to have a liquidity reserve must maintain liquid assets at a minimum equal to five percent of its total dollar liability base. The reserve must be determined on a monthly basis by not later than the tenth day of each month. It is based on the insured cooperative's liability base as of the last working day of the previous month [9:742-1].

EXHIBIT II-2

REGULAR RESERVE REQUIREMENTS



11. Dividend Policy

The board of directors is authorized to define the annual, semiannual, or quarterly dividend periods. They also specify the latest date of the month that deposits receive dividend credit for the month [7:31].

Dividend rates established by the cooperative's board of directors normally vary according to different types of shares held by the membership [8:8]. For example, a Federal credit union may pay a maximum dividend, expressed as an annual rate of seven percent on regular share accounts. The dividend paid on share certificate accounts vary "up to the greater of 9.5 percent, or the lesser of 12 percent, or the average 2-1/2 year yield for United States Treasury Securities, as determined and announced by the United States Department of Treasury" [9:701-29].

F. SUMMARY

This chapter has provided basic background and general information on Federal credit unions. To provide this information, the organizational structure, services provided, and the management operations of a typical cooperative were discussed. Additionally, various preferred Federal credit union practices were presented.

The chapter explained the role and direct responsibilities that the directors have in maintaining management control and establishing operating policies and procedures of the cooperative. Further, the responsibilities of the supervisory

committee, as an internal audit "tool," to assist the board of directors in ascertaining if these policies and procedures are carried out were discussed.

III. INTERNAL AUDITING OF FEDERAL CREDIT UNIONS

A. INTRODUCTION

This chapter explains the primary purpose of an internal audit body and discusses the nature, benefits, and scope of internal audits. Further, the chapter develops the concept that an internal auditing body should perform more detailed tasks in auditing performance of management than merely financial and compliance aspects of an organization. Additionally, the role of internal auditing in appraising operational performance is presented. The chapter also explains the skills and knowledge that an internal audit body must have in the areas of internal and management control systems to effectively audit the cooperative. The last section of the chapter explains the new "single audit" concept of auditing in the Federal government and its potential for application by members of the National Credit Union Administration (NCUA).

B. ROLL OF INTERNAL AUDITING

The primary responsibility of an internal audit body, such as the supervisory committee in a Federal credit union, is to "assist management in evaluating the functioning of systems and controls" [14:87]. For example, a supervisory

committee should ensure that: 1. accounting and financial records or reports are prepared promptly and accurately reflecting results from operations; 2. established internal controls are effectively maintained and adequately protect the cooperative, its members, management officials, and employees; and 3; each department or section of the entity is carrying out the plans, policies, and preferred practices for which it is responsible. Further, the committee should appraise policies and ensure adequate safeguards against errors, carelessness, and fraud. Additionally, through the independent appraisal of operations and policies by the supervisory committee the reputations of management officials and employees are safeguarded against unfair and unfounded criticism by cooperative members or outside interests [15:1]. Through the performance of these functions, an adequate internal audit "tool" can detect most system and control deficiencies, thus providing the organization's management an opportunity to correct them [16:51].

The Comptroller General of the United States in 1974 described the role of internal auditing as:

> Information needed by management may come from direct observation; from routine and periodic operating, accounting, statistical, and analytical reports; and from functional or staff reviews. Another important source of information is the internal audit organization which conducts independent examinations and makes reports on its finding and appraisals of operations and performance. The internal audit function uniquely supplements routine management checks through its independent approach and methods of review. This function is one of the essential tools of management, complementing all other elements of management control [14:88].

This section of the research study explains the nature, benefits, and scope of internal auditing. Additionally, the role of internal auditing in appraising performance in carrying out established policies, plans, and procedures are discussed.

1. Nature of Internal Auditing

Section 113 of the Accounting and Auditing Act of 1950 requires all government agency heads to establish accounting and internal controls to include internal auditing [16:51]. As explained in Chapter II, the Federal Credit Union Act requires the board of directors of a cooperative to appoint a supervisory committee to serve as the internal audit body. The basic objective for each of these internal auditing bodies or departments is to assist management in achieving the goals of the organization by providing "information, analyses, appraisals, and recommendations pertinent to management's duties and objectives" [14:88].

To effectively accomplish these tasks, the auditing body must function in a staff and advisory capacity and not in a line-operating capacity. Internal auditors should not have the authority to directly make changes in established procedures or operations. The auditor's job is to objectively and independently review, analyze, and evaluate existing procedures, practices, and activities. Then he or she reports the findings to management and whenever the auditor deems it necessary, provides recommendations or

other suggestions for management as well as operating officials to consider [14:88].

The internal audit body should not be tasked with direct operating responsibilities. Their primary responsibility should focus on the performances of others. The audit body must maintain an independent outlook in all tasks performed and direct efforts to areas that require corrective action. Their function is to present evaluations and recommendations constructively in such a manner as to stimulate and encourage corrective action [14:89].

2. <u>Benefits of Internal Auditing</u>

Many Federal organizations have adequate written procedures or preferred practices to control its operations or activities. However, often no action is taken by management to enforce compliance with the established procedures or preferred practices. For example, a Government Accounting Office (GAO) report noted that many Federal agencies had adequate formalized procedures to control accounts receivable, but no action was taken to ensure compliance, and in two years, the total amount owed to the government increased 38 percent or 26 billion dollars [16:40]. Benefits obtained from internal auditing are directly related to this inconsistency.

Management officials have found that the services rendered by an internal audit body in the form of "constructive recommendations supported by unbiased, relevant information has aided in meeting many of the problems of both

large-scale and decentralized operations." Internal auditing is an important means by which management can remain informed and evaluate the operations of the organization [14:89]. For example, a report by GAO stated that an active internal audit body can: identify and bring to management's attention weaknesses in established procedures or practices, evaluate the design of accounting and control systems to recommend improvements, and encourage or stimulate an organization's operating departments to conform to established procedures or practices [16:52].

Internal auditing is not only applicable to large organizations, it is extremely important in small organizations or small segments of large organizations where the customary separation of duties among employees is not economical or practical. In situations such as these, the audit body provides an additional internal check and control to ensure effective and efficient operations [14:89].

Additionally, the internal audit body's knowledge of management policies, plans, procedures, and practices coupled with contacts among management officials and employees at all operational levels of the entity can serve to promote better communications and an improved understanding among all parties [14:89].

In Federal credit unions, the supervisory committee can perform additional benefits to assist both the board of directors and management officials. For example, the

committee can assist in resolving any problems encountered in transacting credit union business and informally investigate any member's complaints. Further, the committee can ascertain if members of the cooperative are provided adequate services and equitable treatment [15:2].

3. Scope of Internal Auditing Work

The scope of internal auditing should not be restricted to certain areas or levels within the organization. The audit body should perform audits throughout the organization to be of maximum usefulness. Further, the duties of the audit body should be clearly defined by management officials. Information concerning these duties should be communicated to all operating levels of the organization to insure full recognition of the bodies designated tasks and responsibilities [14:89].

Audits by the supervisory committee in Federal credit unions should range from a simple cash count of the funds held to a review of the director's minutes to evaluate the effectiveness of the board of directors [15:27].

4. Appraising Performance

Internal auditing can provide a valuable function to management by "reviewing, appraising, and reporting on the extent and nature of compliance with established internal policies, plans, and procedures as well as compliance with applicable legal and external regulatory requirements." The internal auditing body's work should include the review of

the operation of the whole system of management controls over all activities and resources to determine if systems are functioning as constructed. To assist the audit body in this task, often comparative examinations of similar operations within the organization can be utilized. Observations and evaluations made of the control systems are reported to management as to their adequacy or effectiveness in relation to overall organizational objectives [14:90].

To appraise performance of an organization, department, or individual, management officials can review quantitative information which is normally expressed in financial terms. For example, revenues earned or expenses incurred. Further, the difference between planned performance and actual performance can be analyzed through the use of variances. Although these quantitative, usually regular financial reports, serve a useful purpose for management in appraising performance, management will probably need additional information [17:475].

An internal auditing body can provide this additional information through performance auditing. By auditing accountable departments, sections, or individuals, the internal audit body can attest to the effective, efficient, and economical use of resources by the auditee and report the findings to the third party which requires the auditee's accountability [18:5]. Performance audits of this type are classified as either management audits or program audits [18:5].

Management audits of an organization ascertain if the "entity's management or employees have or have not accepted and carried out appropriate laws, regulations, policies, procedures, or other management standards for properly using its resources in an efficient and economical manner." Auditors gather sufficient evidence to make recommendations for possible corrections and to convince the party that requires accountability of the auditee [18:7].

As distinguished from a management audit, program audits evaluate and report on the effective use of resources in accomplishing intended results or objectives. Program audits determine if an "entity's management, employees, or delegated agents have or have not accepted and carried out appropriate standards for achieving the results desired by a higher level authority in an effective manner." The auditors gather sufficient evidence in their report to convince the higher level authority and provide recommendations for possible improvement in the effectiveness of the program [18:8]. Performance audits therefore, can assist in monitoring performance by determining whether the "entity is managing or utilizing its resources (personnel, property, space, and so forth) in an economical, efficient, and effective manner as well as identifying inefficiencies, uneconomical, or ineffective practices or procedures" [17:487].

C. INTERNAL AUDIT SKILLS

The internal audit body must be knowledgeable about accounting, data processing, statistical sampling, risk assessment, and general auditing principles. Auditors must also be informed on such matters as the objectives of the organization, internal control systems, and characteristics of an adequate internal and management control systems.

This section of the study explains the characteristics of an adequate internal and management control system. Knowledge that a supervisory committee member should possess to perform internal audits of a Federal credit union is also presented.

1. Internal Control

The American Institute of Certified Public Accountants (AICPA) define internal control as:

> . . . controls which may be characterized as either accounting or administrative as follows:
> Administrative control includes, but is not limited to, the plan of organization and the procedures and records that are concerned with the decision processes leading to management's authorization of transactions . . . Such authorization is a management function directly associated with the responsibility of achieving the objectives of the organization and is the starting point for establishing accounting control of transactions.
> Accounting control comprises the plan of organization and the procedures and records that are concerned with the safeguarding of assets and the reliability of financial records and consequently are designed to provide reasonable assurance that:" transactions are recorded as necessary; transactions are executed as authorized; access to asset's is authorized; and recorded accountability for assets is checked at appropriate intervals [18:122]."

The AICPA stipulates that an adequate system provides reasonable assurance that the objectives of accounting control are achieved and that transactions are executed as authorized. Further, authorizations are issued by individuals acting within their scope of responsibility. The system also ensures proper recording of transactions, limited access to assets, separation of duties, and inventory of actual assets compared with recorded accountability [18:122].

If an audit body discovers that these management and internal control systems have not been developed or are not appropriate to the operations of the organization, there is a strong possibility of inefficient, uneconomical, or ineffective activities [18:122].

The author contends that internal control systems must be verified for these characteristics and must be audited to assure that individuals comply with given standards. Therefore, internal auditing of internal control systems is paramount for good management techniques.

2. Management Control

Management control in performance auditing encompasses both internal and external control of an organization. Further, management control is the "plan of organization and all other plans, policies, procedures, and practices needed by personnel and other resources to achieve the objectives of the entity" [18:121].

The audit body must determine if objectives of an organization include the stated results expected from its activities and a statement of responsibility of management for safeguarding resources and designated accountability for results [18:123].

Adequate management control systems have clear statements of objectives and a plan of organization to accomplish the stated objectives. Additionally, the system has appropriate policies and practices established for each department and an effective method for review at all levels of operations to assure that appropriate policies and practices are carried out. The system also incorporates adequate segregation of duties for personnel [18:123].

Leo Herbert states, that "well managed organizations, public and private as well as profit and nonprofit, understand the necessity for communicating basic objectives of the entity to all levels of the organization." Institutions are effective when they achieve their stated objectives. They are economical and efficient when the methods utilized to achieve goals and objectives produce desired results in the best manner possible given the circumstances [18:123].

When an organization is audited to determine if the methods and activities utilized are related to its objectives, the performance audit is genuinely helpful as a means of improving management vice merely improving the administration of a particular standard [18:123].

After the auditors have ascertained that the objectives for an organization have been established, they must check for proper organization to facilitate achievement of the objectives. To ensure a proper plan of organization, responsibilities should be adequately divided. Management officials should be given authority commensurate with designated responsibilities. Further, no one individual should maintain control of all phases of a transaction. Additionally, each individual must be accountable to some third party for their actions and each accountable individual's actions should be reviewed to determine that assignments and responsibilities are properly accomplished [18:125].

To evaluate if assignments and responsibilities are properly accomplished, appropriate policies and practices must be established for each department or subsection. Appropriate policies and practices are the result of adequate long and short-range planning. This planning is accomplished through the establishment of well defined clearly stated objectives. They define the desired results for the organization and for each of its levels. Individuals in separate levels of the organization then know what is expected of them. Results expected should be appropriately communicated if efficient, economical, and effective operational activities as desired. Policies are normally communicated in the form of policy manuals. However, the performance

auditor must audit actual activities to determine if established policies are being carried out [18:131].

The audit body should also evaluate direct supervision associated with the management control system, since supervisory methods are crucial in determining causes of deficient operations or activities [18:132].

To effectively audit a management control system the auditor must actually test a certain number of transactions so that one can ascertain the actual procedures followed and actual practices applied. When selecting transactions for testing, the audit body should consider transactions representative of the activity or operations of the organization. Therefore, the actual number of transactions or actions selected is less important than their representative character [18:133].

3. Auditor's Qualifications

Although the board of directors can appoint any member to serve on the supervisory committee, it is recommended that appointees have a knowledge of accounting. However, to effectively discharge the duties as an internal auditor, members of the committee should possess certain practical education, experience, and other qualifications to become a competent auditor of credit union activities. For example, committee members should be familiar with the Federal Credit Union Act and Bylaws, which identify the purpose and functions of cooperatives as well as defining the various responsibilities of the officers, directors, and committees.

Further, the Federal Credit Union Rules and Regulations Manual outlines the conditions under which the functions of the cooperative may be accomplished. The Board of Directors Manual, the Accounting Manual, and the Credit Manual for Federal Credit Unions contain numerous preferred operational practices for the cooperative similar to those discussed in Chapter II. Supervisory committee members must be knowledgeable of the contents of each of these manuals and of established preferred practices to evaluate management techniques of a credit union. In addition to a working knowledge in these areas, two other important elements that each auditor should possess are alertness and curiosity [15:2].

Exhibit III-1 represents the historical growth of knowledge needed for the auditing functions from 1775 to 1979 [18:10]. With this rapid expansion of knowledge in the auditing field, it is clear that the supervisory committee will need additional talents if they are to be professional and capable of meeting the challenges of tomorrow.

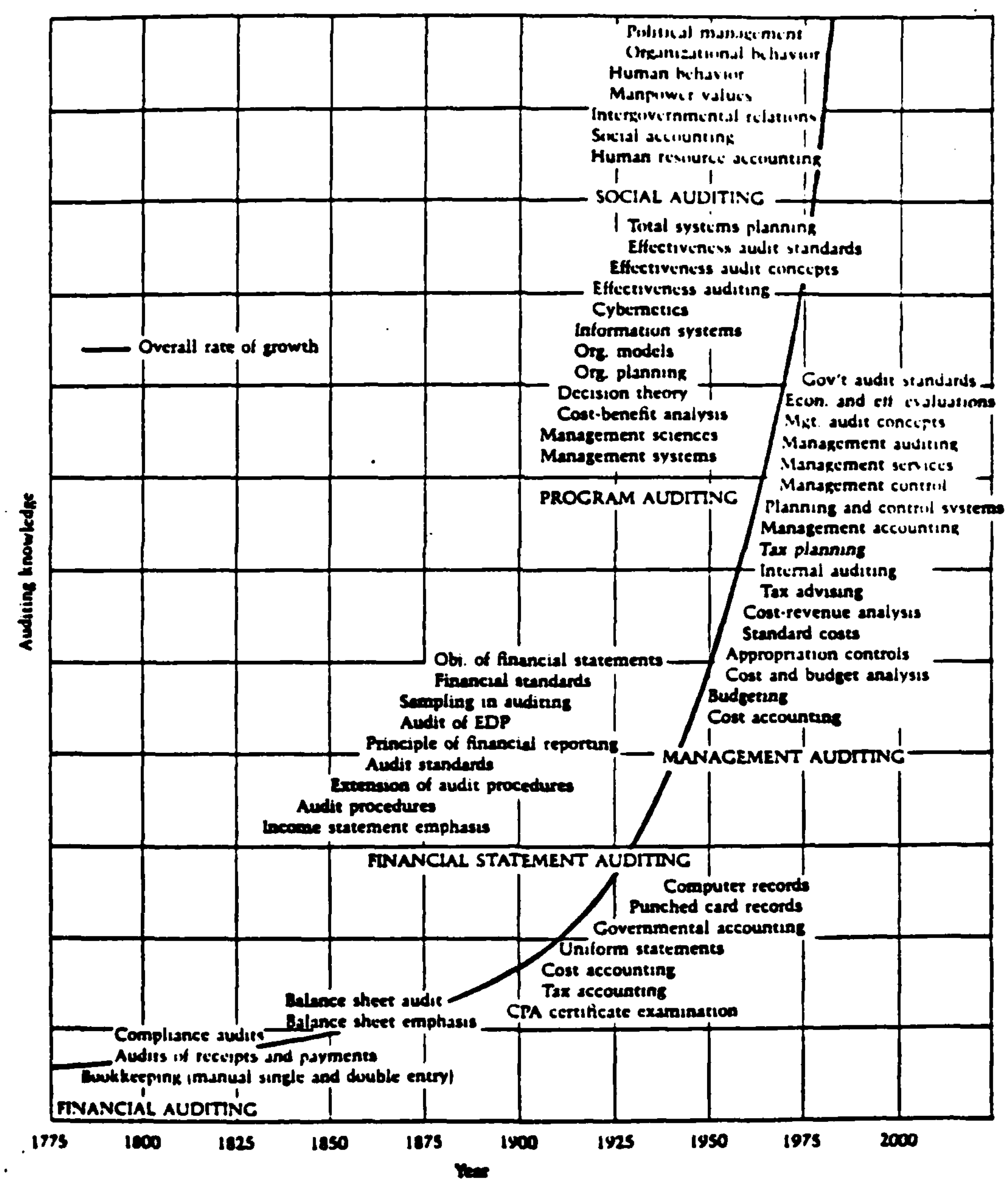
D. "SINGLE AUDIT" CONCEPT

GAO in 1977 published a report entitled, "Grant Auditing: A Maze of Inconsistency, Gaps, and Duplication that Needs Overhauling" [19:29]. The report stated that Federal audit coverage of 85 billion dollars in grants to thousands of state and local governments, nonprofit organizations and other recipients, was not coordinated and failed to ensure effective

EXHIBIT III-1

GROWTH OF KNOWLEDGE NEEDED FOR

THE AUDITING FUNCTION, 1775-1979



surveillance of public funds. Further, audits conducted were directed at specific grants and auditors paid little, if any attention to other Federal grants received by the agency being audited. Thus, after completing one specific audit, the agency was then audited again in a separate grant area. GAO found duplicative and repetitious auditing, as well as large gaps in audit coverage that could result in millions or billions of dollars being subject to fraud, waste, and abuse [19:29].

In an attempt to correct this problem, the Office of Management and Budget (OMB) issued Circular A-102 in October 1979. Attachment P of this circular requires that all state and local government receiving Federal grants be audited at least every two years. It is OMB's intent for a single audit program to satisfy requirements of all agencies requiring audits. With this approach OMB is optimistic that the audit of an entity will cover the whole spectrum of grants received, "rather than examining programs on a piecemeal basis" [19:29].

The Supervisory Committee Manual for Federal Credit Unions does provide guidance to the committee in conducting annual audits to verify the balances of member's accounts. It also aids auditors in evaluating other financial and non-financial aspects of the cooperative but it does not include an audit program to review many of the preferred practices discussed in Chapter II. Further, the potential for applying

the "single audit" concept to Federal credit unions has not been examined by the NCUA. However, a single audit program for preferred practices could have a positive impact on operations of Federal credit unions. Additionally, a guide for key areas could greatly enhance audit capabilities of the supervisory committee and expand the review function of examiners assigned to NCUA Regional Offices.[1]

E. SUMMARY

In this chapter the duties and responsibilities of an internal audit body were discussed. Further, the characteristics of adequate internal and management control systems were explained. Finally, GAO's single audit program to reduce inconsistences, gaps, and duplication in Federal grant auditing was presented and the potential benefit of developing a similar audit program for Federal credit unions was discussed.

Chapter IV displays the results of a research questionnaire concerning the internal and external auditing of Federal credit unions. Additionally, it explores the formal and nonformal training of members assigned to the supervisory committe and examines the need for a single audit program to enhance the performance of Federal credit unions.

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[1]Lubina, D., National Credit Union Regional Examiner, San Francisco, conversation on 6 March 1981.

IV. OVERVIEW OF SURVEY AND DESCRIPTION OF RESULTS

A. INTRODUCTION

This chapter discusses a survey on internal and external auditing performed in Federal credit unions. First, the survey methodology and scope of the survey is discussed. Additionally, the survey sources and survey questions is then addressed. This chapter presents only the survey results and analyzes the relationship that may exist between the answers for the various questions. Conclusions drawn from these relationships and recommendations will be presented in Chapter VII.

B. ORGANIZATIONS SURVEYED, SURVEY METHODOLOGY, AND SCOPE OF SURVEY

In this study, answers to the questions detailed on the survey questionnaire attached as Appendix A were obtained by a random sample taken from general managers of Federal credit unions. Due to limitations in time and funding, all ganizations sampled conduct operations in the state of California. Cooperatives in the Monterey Peninsula, San Francisco Bay, and San Diego areas were included in the distribution of the questionnaire. The largest credit union to receive a questionnaire had a total share balance of over 75 million dollars and a membership of over 48 thousand. The smallest credit union included had a total share balance of just over 94

thousand dollars and a membership of 337. A total of 65 organizations was selected within this range and mailed a questionnaire. Responses to the questionnaire were submitted anonymously and 32 questionnaires were returned for inclusion in this study. Names and addresses of cooperatives sampled were obtained from the San Francisco Regional National Credit Union Administration Office in San Francisco, California.

The survey was designed to evaluate internal and external auditing performed in Federal credit unions in the state of California. Specifically, the survey was organized to evaluate types of audits performed, the auditing body, audit programs utilized, training and experience of auditors, and the need for a single audit program in cooperatives. In addition, the need for auditing systems, controls, procedures, and practices in Federal credit unions was also addressed.

C. SURVEY QUESTIONNAIRE

1. Survey Sources

The survey attached as Appendix A was developed from several sources. These sources included numerous publications received from the National Credit Union Administration (NCUA) and questions extracted from Pomeranz's, etal *Auditing in the Public Sector*.

2. Survey Questions

Appendix A consists of 11 basic questions with numerous subquestions concerning audits of Federal credit unions.

The author feels that the survey questions are self-explanatory when combined with the information presented in Chapters II and III. However, the Government Accounting Office's (GAO) definitions for a financial and compliance audit, economy and efficiency audit, and a program results audit were included in the basic questionnaire as an enclosure for all respondents to review prior to completing the survey.

These definitions are included here for reader familiarity with the different types of audits.

Financial and Compliance Audits- "determines (a) whether financial operations are properly conducted, (b) whether the financial reports of an audited entity are presented fairly, and (c) whether the entity has complied with applicable laws and regulations" [14:5].

Economy and Efficiency Audits- "determines whether the entity is managing or utilizing its resources (personnel, property, space, and so forth) in an economical and efficient manner and the causes of any inefficiencies or uneconomical practices, including inadequacies in management information systems, administrative procedures or organizational structure" [14:8].

Program Results Audits- "determines whether the desired results or benefits are being achieved, whether the objectives established by the legislature or other authorized body are being met, and whether the agency has considered alternatives which might yield desired results at a lower cost" [14:8].

In order to provide an adequate overview, a synopsis of the basic questions in the questionnaire is presented as follows. First, the asset base and membership of the cooperative was established to ensure the random inclusion of various size cooperatives. Questions two through five endeavor to solicit information concerning annual audits performed,

auditors involved, and audit programs, objectives, or audit guides for audit tasks. Further, the auditing experience of the supervisory committee and the considered adequacy of this experience to perform audits of Federal credit unions was explored. Questions six through eight include numerous subparts concerning the need for a "single audit" program for key areas of the cooperative, the audit entity that would benefit, and an evaluation by the respondents to the activity of the supervisory committee as an internal auditing body. Question nine contains three parts directed at determining the perceived need by the respondents for audits of the credit union. Question ten attempts to determine whether internal audit activities are directed toward audit assignments or clerical tasks. The last question of the survey solicits the number of audits the respondents received in 1980 and asks the general managers to classify these audits according to the GAO definitions.

D. RESULTS AND ANALYSIS OF THE SURVEY

1. General

Survey results have been consolidated and are presented in Exhibit IV-1. Exhibit IV-1 also presents the questions detailed on the survey shown in Appendix A. Further, Exhibit IV-1 separates each of the questions shown in Appendix A into its various subquestion parts. Most of the survey questions were designed to solicit "yes" or "no" responses from the

general managers. The number of general managers responding to each of the questions is noted in parenthesis at the end of each question and the number of respondents who answered "yes" to a question is displayed in both numerical and bar graph percentages. Six of the survey question subparts cannot be answered "yes" or "no" but require short answers. These answers are included with the discussion of the various questions in this section. Further, the last part of this section of the study presents various additional comments made by general managers concerning auditing of Federal credit unions.

2. Asset Base and Membership

A respondent with an asset base of 100 million dollars and 50 thousand members was the largest organization sampled. Conversely, the smallest asset base sampled was 150 thousand dollars and 315 members. However, two respondents did not indicate either the asset base of the cooperative or the number of members. One respondent indicated a membership of 200, but did not include the organizations asset base.

3. Annual Audits

All respondents indicated that they received annual audits. Further, in 97 percent of the cases these annual audits were performed by external auditors in financial and compliance areas.

Additionally, all respondents indicated that internal

audits of the cooperative were conducted by at least one of the audit entities addressed in the questionnaire. Eleven managers did not respond to the question, "Is auditing conducted internally by management officials?" Further, in response to the question, "Is auditing conducted internally by the supervisory committee?", six general managers did not respond. However, of the managers that did respond to the questions, 62 percent indicated that management officials perform internal audits and 85 percent indicated that the supervisory committee performs internal audits of the organization. Twelve general managers, or 38 percent of the respondents, indicated that internal audits are conducted by certified public accounting firms, management firms, or by external auditors. In each of these cases, the firm or external auditor was hired by the supervisory committee to perform the internal review. Forty-four percent of the respondents indicated that internal audits are performed by at least two of the audit entities addressed in the questionnaire. For example, both the supervisory committee and management officials conduct internal audits. Three general managers indicated that internal reviews are performed by management officials, the supervisory committee, and also by certified public accountants. Therefore, 53 percent of the respondents utilized two or more audit entities to perform internal audits of the cooperative.

4. Auditing of Functioning Systems, Controls, Procedures, and Practices

All respondents, except one, indicated that annual audits are conducted on functioning systems, controls, procedures, and practices. Further, the managers indicated that 88 percent of the cooperatives utilize external auditors, 62 percent utilize the supervisory committee, and 48 percent utilize other auditing sources to perform these annual audits. The other sources utilized include the NCUA, bonding companies, management services companies, certified public accounting firms, and the California Credit Union League Technical Assistance Group. Fifty-two percent of the managers indicated that economy and efficiency audits are included in these audits and 31 percent indicated that program result audits are included. Fifty percent of the sample indicated that these audits are performed by at least two of the groups addressed in the questionnaire. Additionally, six respondents indicated that all three groups addressed in the questionnaire are utilized to perform the auditing of functioning systems, controls, procedures, and practices. Therefore, 69 percent of the general managers indicated that two or more of the groups addressed perform these audits.

5. Verifying each Members Share and Loan Balances

Forty-eight percent of the managers indicated that the supervisory committee performed annual audits other than

verifying each member's share and loan balances. The additional areas audited by the committee included general accounting transactions, loan procedures, loan application, balancing of the general ledger, closed accounts, cash counts, delinquent loans, general records, investment policies, minutes of the board of directors, and internal controls. Further, 75 percent of the respondents indicated that the supervisory committee conducted annual audits to verify member's share and loan balances. Additionally, 84 percent of the managers indicated that audit tasks of the committee are guided by programs, objectives, or audit guides. Twenty-seven respondents indicated that other auditing agencies have audit programs, objectives or audit guides for audits performed in the cooperative. Ninety-six percent of the managers also indicated that internal audit programs, objectives, and/or audit guides are revised to reflect changing conditions.

6. Experience Level

Respondents indicated that the average experience level in auditing of members assigned to the supervisory committee was 5.53 years. Four managers indicated they did not know the level of experience of the members on the supervisory committee. Only seven respondents indicated that [illegible] of their supervisory committee had received formal [illegible] auditing. Eighty-six percent of the managers [illegible] committee members received their experience

through "on-the-job training." Further, only 46 percent of the respondents considered the experience level of committee members adequate to perform audit work in credit unions. Two general managers indicated that members of their supervisory committee had attended workshops in auditing and received training from the California Department of Corporations.

7. Single Audit Program

Eighty-nine percent of the general managers indicated that a "single audit" program for key areas in the credit union would be beneficial. A total of 28 managers responded to the question with only three indicating that such an audit program would not be beneficial. Seventy-seven percent of the respondents indicated that the program would be beneficial to external auditors. The interesting aspect to this question is that even though a majority of the respondents indicated the "single audit" program would be beneficial to various auditing entities, only 54 percent of the respondents reflected that such a program would reduce multiple visits to the cooperative by auditors, thereby saving time and money to the credit union. Twenty-four general managers did not respond to either the basic question or to one or more of its subquestions.

8. Active Internal Auditing Body

Fifty-two percent of the respondents indicated that the supervisory committee of their cooperative was an active internal auditing body. However, five managers who indicated

the supervisory committee was an active internal auditing body also indicated that the committee does not perform annual audits other than to verify each members share and loan balances. Further, three of the remaining 11 respondents who considered the committee an active internal auditing body indicated the experience level of the committee was not adequate to perform auditing in credit unions.

9. Improved Internal Auditing Body

Fifty-nine percent of the general managers indicated that a single audit program for key areas of the cooperative would make the supervisory committee a more active and beneficial internal auditing body. Eighty percent, or 12 of the respondents who indicated the supervisory committee was not an active internal auditing body indicated that a single audit program would enhance the efforts of the committee and make it a more active and beneficial internal audit body. Further, five of the managers who indicated their supervisory committee was an active internal review body reflected that a single audit program would benefit the committee. Three general managers however, elected not to respond to this question.

10. Need for Auditing of Systems, Controls, Procedures, and Practices

Seventy-three percent of the managers indicated that there is a need for auditing systems, controls, procedures, and practices in their cooperatives. Further, 63 percent indicated a need for economy and efficiency audits and 59

percent indicated a need for program result audits. Seven respondents did not respond to either the basic question or to one or more of its subquestions.

11. Audit Assignments

Twenty-two general managers indicated that internal audit activities are directed toward audit assignments, rather than clerical tasks. However, four respondents did not answer the question and one respondent indicated that audit activities are directed toward both audit assignments and clerical tasks.

12. Audits Performed in 1980

In calender year 1980, the general managers indicated that 43 financial and compliance audits were performed or 1.34 audits per respondent. Further, 17 economy and efficiency audits were conducted and 13 program result audits completed. A total of 48 member share and loan balance audits were performed and seven audits were conducted in other cooperative areas. The other audit areas included audits in Insurance (Surety Bond), workmans compensation, state regulatory requirements, and other audits normally classified as financial and compliance audits. Thus, 32 cooperatives received 128 audits for calender year 1980 for an average of four per cooperative.

13 uestionnaire Comments

The following are additional comments made by various general managers on the auditing questionnaire.

"We are currently audited to death. It has lost benefit - eight audits conducted last year. Only CPA and supervisory committee beneficial."

"The government agencies would never agree with a private sector single audit program. Theory good but reality impossible. Government audits are conducted by inexperienced personnel unsure of what they're looking for. Duplicity in audits mainly in this area and no one agency would have expertise to handle a comprehensive audit. No agency would give up their regulatory power willingly."

"Generally audits are not held by the supervisory committee except in smaller credit unions. The supervisory committee is charged with hiring our firm and with the responsibility of completing or correcting areas of criticism or areas of non-compliance to regulations."

"Our supervisory committee is not in a position to actually conduct an audit. They hire a certified accounting firm to conduct the audit and members verification of accounts annually. The state of California then conducts an annual compliance examination. Management uses a part time management services company to reconcile the bank statements, help prepare and police the daily summary and general ledger work. (Reason: Lack of available qualified personnel in the credit union field.)"

"Credit unions have always had a problem with the volunteer, who wants to do the job, but lacks credit union knowledge. We are unique as far as being a financial institution - not a bank, not a savings and loan but a mutual thrift organization, so we don't have the personnel training available to us that we need."

"Our supervisory audit is performed by a private firm and is a good audit for management, but the process is incomplete for the committee. They lack the time and expertise necessary to evaluate the audit."

"The members of the supervisory committee do not conduct any audits themselves. The supervisory committee decides each year whether to select a CPA firm to conduct the Annual Audit or not. If an outside auditor is not selected, the State Department of Corporations conducts an examination of financial records and a compliance examination. The State examination is not a certified audit.

The state has the option of conducting an examination every year even though an outside auditor is selected. This option is only exercised about one out of every three years.

The formal audit report includes only financial and compliance items. However, the management letter includes economy and efficiency items."

E. SUMMARY

In summary, this chapter dealt with an internal and external audit survey of Federal credit unions in the state of California. The survey scope, methodology, sources, and questions were discussed. In addition, the survey results were presented and reviewed.

EXHIBIT IV-1

FEDERAL CREDIT UNION SURVEY RESULTS ON INTERNAL AND EXTERNAL AUDITING

(1) Asset Base and Membership

Largest: 100 Million

50 Thousand Members

Smallest: 150 Thousand

317 Members

(2) Does the credit union receive annual audits? (32)*

(a) Is this auditing conducted by external auditors? (32)*

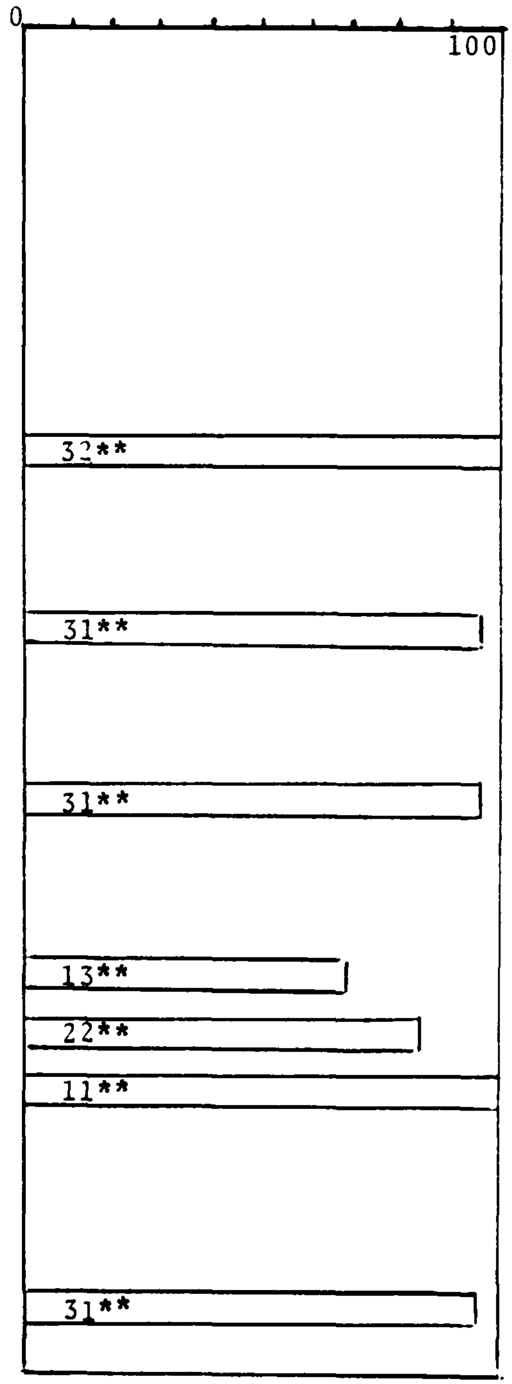
(b) Is this auditing conducted in financial and compliance areas? (32)*

(c) Is auditing conducted internally by: Management Officials (21)*

Supervisory Committee (26)*

Other (11)*

(3) Is auditing conducted annually on functioning systems, controls, procedures, and practices? (32)*



(a) Is this auditing conducted by external auditors? (32)*

(b) Is this auditing conducted by the supervisory committee? (29)*

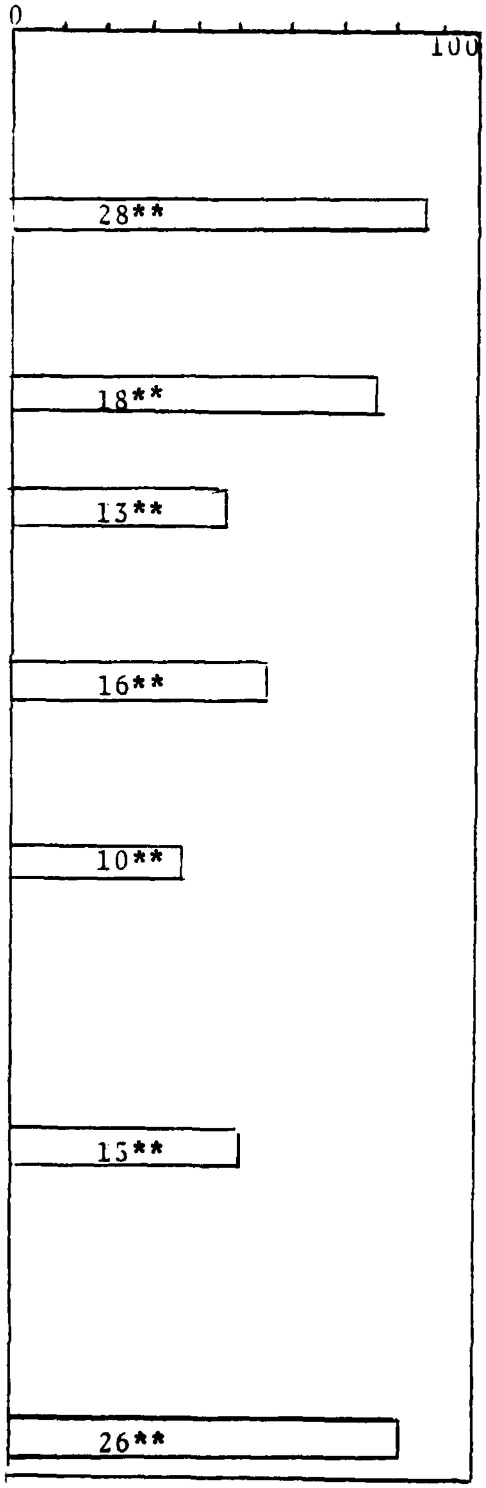
(c) Is this auditing conducted by other sources (27)*

(d) Does this auditing include economy and efficiency audits? (31)*

(e) Does this auditing include program results audits (32)*

(4) Does the supervisory committee perform annual audits other than verifying each members share and loan balances? (31)*

(a) Does the supervisory committee perform annual audits to verify each members share and loan balance? (32)*



(b) Are audit tasks of the supervisory committee guided by programs, objectives, or audit guides? (31)*

(c) Do other auditing agencies have audit programs, objectives, or audit guides for audit tasks? (29)*

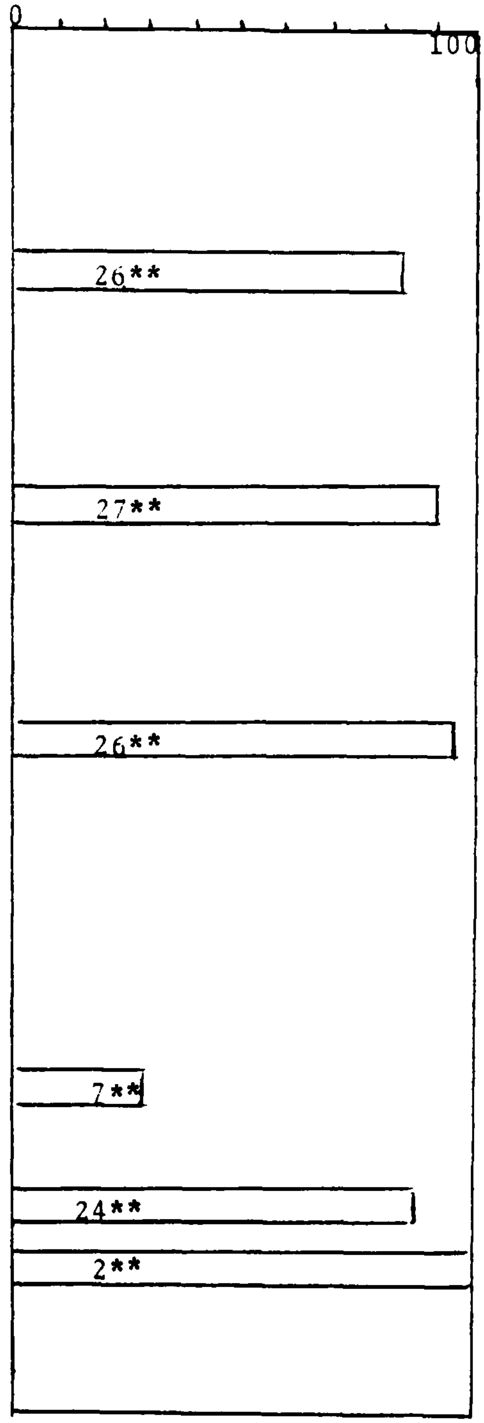
(d) Are internal audit programs, objectives, and/or audit guides revised to reflect changing conditions? (27)*

(5) Average experience in auditing of members on the supervisory committee is 5.53 years. (28)*

(a) Is this experience formal training in auditing? (28)*

(b) Is this experience on-the-job training in auditing? (28)*

(c) Other (2)*



(d) Do you consider this experience level adequate to perform audit work in the credit union? (31)*

(6) Would a single audit program for key areas in the credit union be beneficial? (28)*

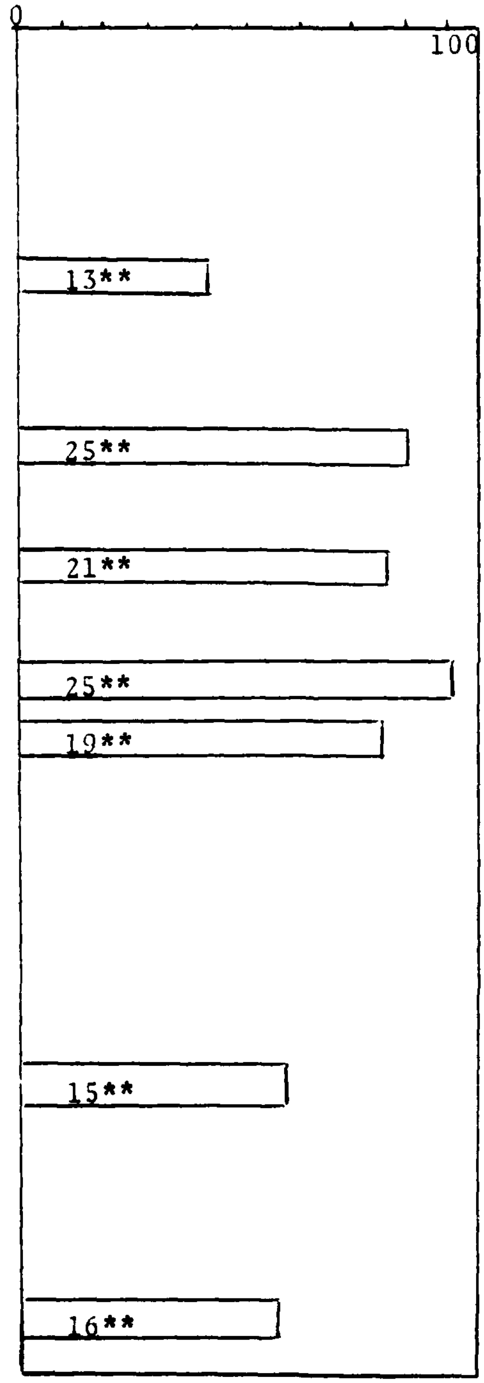
(a) To the supervisory Committee? (27)*

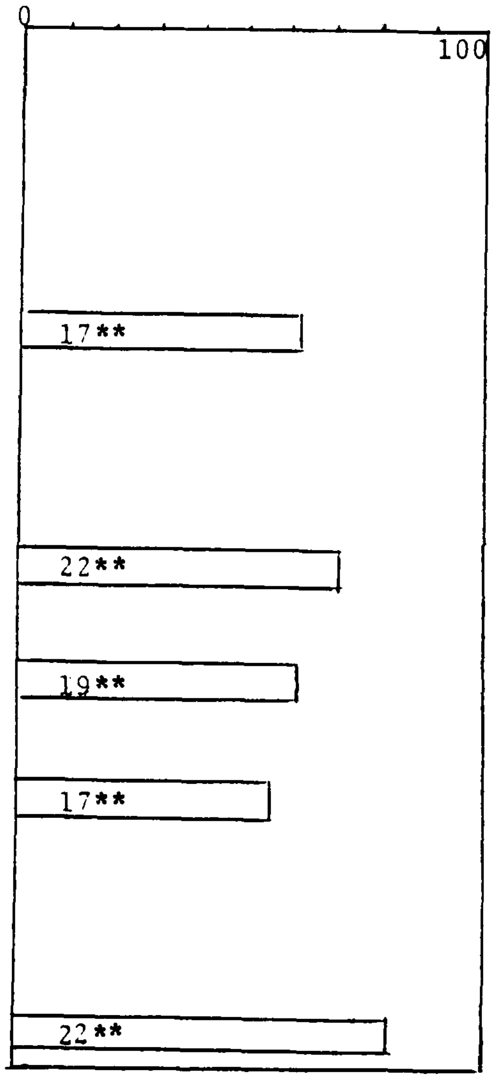
(b) To management officials? (28)*

(c) To external audit body? (25)*

(d) Would a single audit program reduce multiple visits to the credit union by the audit agency, thereby saving time and money to the credit union? (28)*

(7) Do you feel that the supervisory committee of your credit union is an active internal auditing body? (31)*





(8) Would a single audit program for key areas make the supervisory committee a more active and beneficial internal auditing body? (29)*

(9) Is there a need for auditing of systems, controls, procedures, and practices in your credit union? (30)*

(a) Need for economy and efficiency audits? (30)*

(b) Need for program results audits? (29)*

(10) Are internal audit services directed toward audit assignment, rather than clerical tasks? (28)*

(11) In calender year 1980, this credit union received an audit in:

	NUMBER
(a) Financial and Compliance areas (32)*	43
(b) Economy and efficiency areas (32)*	17

	NUMBER
(c) Program results area (32)*	13
(d) Members share and loan balance area (32)*	48
(e) Other areas (32)*	7

*denotes the number of general managers responding to the question.

**denotes the number of "yes" answers in relation to the number responding.

V. A "SINGLE AUDIT" MODEL FOR FEDERAL CREDIT UNIONS

A. INTRODUCTION

In view of the research conducted in Chapter IV, this chapter develops a "single audit" program to review key operational areas in Federal credit unions. The primary objectives of this program are to expand the audit coverage provided by the supervisory committee, enhance the quality of audits performed, reduce the number of audits required, and to eliminate inconsistencies, gaps, and duplication of audits. To achieve these objectives, the "single audit" program combines the various preferred operational and fiscal practices addressed in Chapter II, the internal audit practices of Chapter III, and other preferred practices concerning auditing the performance of management, into a "single audit" guide.

First, the chapter explains the elements of criteria, cause, and effect in defining an audit objective. The chapter then presents the separate audit phases utilized to determine an audit objective and to perform an internal or operational review. The last section of the chapter presents the multipurpose "single audit" program.

B. PERFORMANCE AUDITING

This section of the chapter explains how an audit objective is established and the elements that comprise an adequately

defined objective. Further, the separate phases of a performance audit are explained as well as the role of the auditor in each phase.

1. Defining the Audit Objective

Auditors perform operational reviews or internal reviews, to decide whether management officials or employees have or have not accepted and carried out appropriate preferred practices or standards, and thus utilized resources effectively, efficiently, or economically. However, to facilitate the accomplishment of an internal review, the auditor must identify the specific audit objective for the review. Normally, the audit objective is the "point of issue, the proposition to be proved, the question to be answered, the hypothesis to be proved, or the allegation to be proved." Once the audit objective has been established, the auditor then plans for, gathers, and evaluates evidence in relation to the objective. Further, defining the audit objective provides general guidance for the review and avoids misinterpretations as to the basic purpose of the audit [18:20].

The audit objective established should contain the three elements of criteria, cause, and effect. Criteria for the objective is the preferred practice or the appropriate standard that should be followed when conducting cooperative activities. The cause element of the objective is the actual action or actions that either management or employees utilize

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when conducting cooperative activities. Effects are the results from not following the preferred practice or the measurement of the causes against the criteria. Each established audit objective should contain these three essential elements. An example of an audit objective that contains the three elements is: has the weekly deposit of cash receipts (cause) instead of daily deposits (criteria) resulted in the loss of 10,000 dollars annually in investment income to the cooperative (effects) [18:21]?

One can see that sufficient, competent, and relevant evidence to prove or disprove this "point of issue" should be reasonably obtainable for the auditor. Further, once the evidence has been obtained, the auditor then forms opinions, judgements, conclusions, and/or recommendations on the audit objective [18:21].

2. Survey and Planning Phase

The survey and planning phase or preliminary survey phase of an internal audit is intended to be an educational process for the auditor. This initial phase of the review is designed for the auditor to gather necessary background and general information on all aspects of the cooperative, activity, program or system to be reviewed and to plan for succeeding audit phases. From the preliminary survey the auditor obtains a complete working knowledge of the entity and makes preliminary tests of management control. To facilitate obtaining

descriptive information, the auditor should meet with key officials and employees, examine relevant historical and operational records, budgets, policy and procedure manuals, and consultant's reports [14:19]. This review will assist the auditor in identifying areas where effectiveness, efficiency, or economy might be improved and expose activities that warrant further attention. Additionally, the auditor should begin to develop a tentative or possible audit objective from the review and determine the specific steps that will be required to collect evidence on each element of the objective [18:65].

GAO standards for auditing of governmental organizations require that the scope of the audit be established during this initial phase. The scope of an audit must clearly explain the objectives for the audit and the nature and degree of work to be performed. Usually, the scope can be determined through the survey results by identifying the activities or actions which warrant further attention. The "results expected on each assignment should be stated as clearly as possible within the framework of the elements of the audit objective." The auditor can then summarize briefly the methods that will be utilized to accomplish the intended results, "the planned reporting pattern, and any other points concerning the way the audit will be managed to achieve the results." [18:68-374].

After the survey phase has been completed, a summary of work completed should be developed to facilitate planning,

which involves coordinating the preliminary survey phase of the audit in order to achieve the intended results. The primary purpose of a summary is "to sum up in a clear, concise, and convincing manner and to bring to the forefront the essence of the work performed, the results achieved, the conclusions reached, and any recommendations as reflected in the supporting evidence" [18:174].

Additional considerations the auditor should plan for in the preliminary survey phase are staff and time estimates for the preliminary work as well as the detailed examination. Further, target dates for completing the review and the reporting phase should also be estimated during this time. It is essential in the planning phase to allow for the development of sufficient, competent, relevant evidence to support any opinion, recommendation, or conclusion that may be developed [18:64].

Results of the preliminary survey phase form the basis for the audit program in the detailed examination. Further, the auditor should not commence the detailed examination until an audit program has been developed that identifies a "specific audit objective for the detailed examination and specific audit steps for accomplishing that objective" [18:65].

3. Review Phase

The review phase or the detailed examination phase of the internal audit is that phase normally considered as the audit. In this second phase of the audit, additional background data the auditor deems necessary are obtained on the

audit objective. Further, the auditor gathers sufficient, competent, material, and relevant evidence to ascertain the acceptability of the criteria, the specific action or lack of action that caused the effects, and the significance of the effects. Conclusions are then drawn from the summarized evidence to evaluate the performance of management or employees against the criteria [18:39].

Evidence gathered in the detailed examination phase come from four sources. One source is physical evidence which is obtained through inspection or observation of activities, events, or property. Testimonial evidence is developed through the collection of letters, or statements, received as the result of questionnaires or interviews. Documentary evidence is the most common form and is further categorized as either external or internal. The last source of evidence is analytical, obtained by either verifying or examining information [18:146-147].

However, the auditor must at all times consider evidence in the light of its relevance, materiality, competence, and sufficiency. Relevant evidence is that evidence which possesses some logical relationship to the criteria of the audit objective. Materiality of the evidence pertains to the basic weight each item of evidence carries in influencing the auditor in regard to conclusions on the audit objective. Competency of evidence is the reliability the auditor can

place on the source of information received. Sufficiency is the characteristic that leads another qualified individual to the same conclusion as that reached by the auditor [18:144-146].

All evidence gathered during the detailed examination phase on the audit objective is maintained in the auditor's working papers. Information gathered from the preliminary survey phase of the audit is also recorded in the working papers even though most of this information is descriptive in nature. The main purpose of working papers is: 1. to provide a record of information and evidence on the audit objective. 2. "to provide a record of evidence on the competency of the evidence gathered on the audit objective." 3. to provide the basis for the audit program for the detailed examination from the preliminary survey working papers. 4. to provide the basis for the management letter from the detailed examination working papers [18:161-163].

4. Reporting Phase

This phase is the final phase of the internal review. It is concerned with the actual reporting to the appropriate activity of the results of the overall review effort. The reporting is normally conducted by the use of a management letter. The auditor should set the scene in the report by utilizing background or general information or through identifying the scope of work performed. Further, the auditor communicates conclusions, stating the significance of the

effects caused by not complying with preferred practices. Additionally, sufficient evidence on criteria, causes, and effects should be given coupled with the audit objective for the reader of the report to come to the same conclusion as the auditor. The auditor should also state recommendations for correcting deficiencies if appropriate [18:39].

Prior to developing or drafting the formal management letter, the auditors should hold a "close out" interview with the appropriate management officials. In this interview the auditors and management discuss each audit finding and agree on the appropriateness and the correctness of each finding. Through the "close out" interview both the auditors and management receive feedback on the audit as well as avoiding possible future embarrassment.

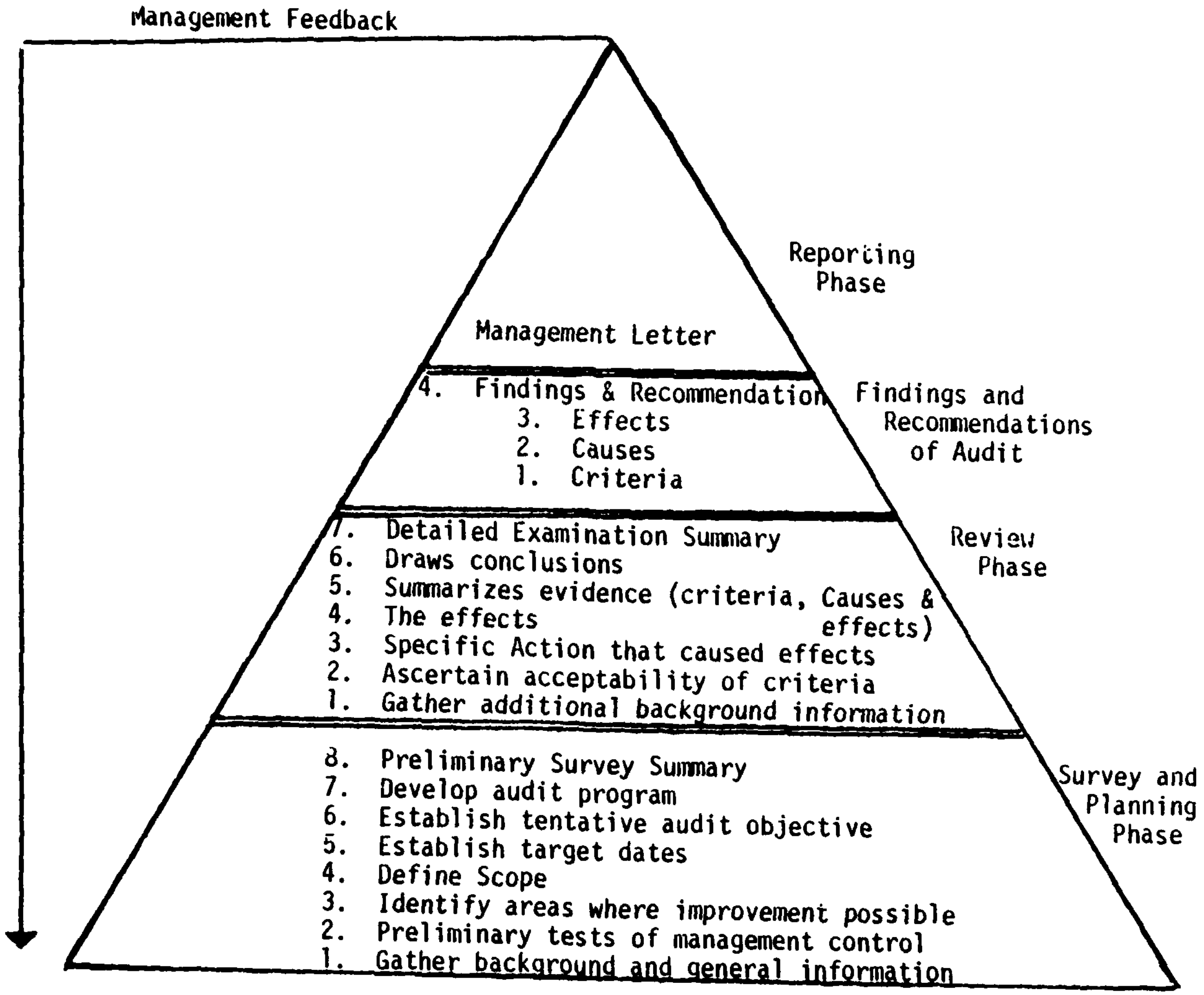
Exhibit V-1 is a diagram of the separate phases of an internal or operational audit and identifies the key elements of each phase.

C. MULTIPURPOSE "SINGLE AUDIT" PROGRAM

The research conducted in Chapter IV reflects that numerous managers of Federal credit unions believe they are "audited to death" and that "the audit process has lost its benefit." Further, a majority of the managers consider the experience level of members on the supervisory committee as inadequate to perform audits of the cooperative. Therefore, one objective of this multipurpose "single audit" program

EXHIBIT V-I

OPERATIONAL AUDIT MODEL



is to make one audit or review satisfy as many National Credit Union Administration (NCUA), other federal, state, and management needs as possible and practicable. Another objective of the program is to provide an audit guide for members of the supervisory committee to utilize in conducting the preliminary survey and the detailed examination, thus enhancing the pro ability of adequate internal audits and effective controls.

The various programs that comprise the "single audit" guide in this section identifies source documents and data the supervisory committee should review in the preliminary survey phase of the audit. Review of this general information in the functional areas and discussions with management officials as well as other key personnel will enable the committee to develop a tentative audit objective for the internal review. The detailed examination can then be made by utilizing the "single audit" program.

The following audit guide is only a guide and all of the specific audit steps of each program may not apply to all cooperatives. It is extremely important that an auditor have the competence, authority, and independence to tailor the audit guidelines to the particular conditions at the time of the audit and the particular cooperative being audited.

1. Fiscal Administration

Fiscal administration of a cooperative can be divided into two major activities: one dealing with basic financial control and the other dealing with financial management.

Although these separate activities are often conducted by the, same organizational segment, they will be treated separately since the former deals with clerical tasks and the latter managerial.

> a. Basic Financial Control
> The overall objective in financial control is that cash be brought under control as quickly as possible, cash on hand be kept to a minimum, maximum separation of duties, and positive control over disbursements.

It is important in these activities that a rule of reason prevail in establishing controls. Due to the activity being subject to abuse, the implementation of controls that are not cost-effective can be prevalent. Therefore, controls in these activities must continually be evaluated to ascertain their cost-benefit relationship

(1) Cash Controls

Cash control is an important element in any organization because cash is the most transferable tender and thus the most vulnerable to abuse. The objective in cash control activity is to achieve a high degree of protection and control. Therefore, an internal auditor must "critically appraise each situation within the cooperative and determine what degree of compromise from a control standpoint is justified due to operational considerations"[20:326]. Consequently, this segment is concerned with receiving cash, cash handling and custody, cash disbursements, and other general aspects of cash transactions.

The receiving of cash function encompasses receipts made by tellers and receipts by mail. Controls in this function that the auditor must evaluate should focus on both outside parties, to be sure cash received should be received, and on employees, to be sure that cash received is not improperly diverted. Key principles of control for the receiving of cash consist of:

1. Accountability established at the earliest possible time.

2. Relief of internal accountabilities tied to cash receipts to the extent practicable.

3. Controls instituted to assure collection for services provided.

4. Outside parties and members utilized where possible, as a further control.

5. Consolidation of cash receiving points.

6. Cash receipts separated from cash disbursements.

7. Accountabilities properly established for all transfers.

8. Records covering accountabilities being independently operated [20:327-328].

Although the cash handling and custody function of cash control is interwoven with the cash receiving and disbursement functions of the cooperative, the following key controls points of this function are:

1. Adequacy of physical safeguards.

2. Minimum cash on hand.

3. Earning potentials realized to the extent practicable [20:329].

The principle objective for the cash disbursement function is to ensure that cash payments are made for valid and proper purposes, that fair value has been received, and that payments are made in correct amounts. Control aspects for this function which the auditor should evaluate include:

1. Separation of the disbursement function
2. Adequacy of documentation for liquidation of payables.
3. Use of petty cash funds.
4. Use of branch imprest funds.
5. Control over check signatures.
6. Designation of payee of checks.
7. Maximum separation of duties and responsibilities [20:329-331].

Other general aspects of cash transactions that the internal auditor must review in the performance of audit of cash control include:

1. Bonding of employees
2. Maximum exploitation of mechanical aids.
3. Keeping records up-to-date and prompt reporting.
4. Control of blank checks and other supplies.
5. Independent reconciliations of bank accounts [20:331-332].

(2) Payable Process. The payable process of a cooperative is concerned with making payments for expenditures on materials, supplies, salaries, and wages, and general services contracted. This process has to do with the complete cycle of recognition of an obligation, recording of the obligation, and subsequent payment. This function of cash control tends to merge with

the cash disbursement function previously discussed, however, the auditor should review the following key aspects:

1. Reasonable relationship between expenditure and operations.
2. No excessive quantities available.
3. Correctness of prices and terms.
4. Services invoiced having been received.
5. Coordination and control of incoming invoices.
6. Proper accounting distributions.
7. Subsidiary ledger control.
8. Planning for payment dates.
9. Final assembly and matching of supporting documents.
10. Deduction of counter claims
11. Preparation of checks.
12. Final review and payment [20:340-342].

Constructing an effective method of cross-checks between employees and management can assist in maintaining many of these control points.

(3) Payrolls. The payroll process of a cooperative is concerned with the prompt and accurate payment of salaries and wages to employees. Payroll costs from the basic heart of the cooperative. Unhappy or concerned employees do not provide a cordial working atmosphere. The internal auditor must determine in the review of payrolls whether the cooperative is satisfying requirements of minimum wage legislation, unemployment insurance, and social security.

This function is directly related to the personnel department of the credit union. Personnel folders contain application forms for employment and the conditions of employment. Further, they contain changes in status and compensations to be provided. Therefore, personnel records become a major source of reference for the auditor. Key control points for the auditor to verify in the payroll function are:

1. Accumulation of work evidence.
2. Application of rates.
3. Accounting distributions.
4. Application of deductions.
5. Determination of net pay [20:347-348].

The first section of Exhibit V-2 represents the audit program for the basic financial control of fiscal administration. This guide combines the control points to be verified by the auditor and provides a "tool" to conduct the internal review.

<u>The supervisory committee must recognize that Exhibit V-2 is only an audit guide for the basic financial control function and that all audit steps delineated may not be applicable to all credit unions. The committee must tailor the program to the specific needs of their cooperative.</u>

b. Financial Management

The financial management activity of fiscal administration encompasses the financial liquidity of the

cooperative, the management of capital resources, as well as the coordination and integration of segments of the entity for maximum profitability to members. In review of this function, the auditor must not only evaluate basic financial operations but also the higher level financial policy dimensions of the cooperative.

> The overall objective of the financial management function is concerned with an effective organization to manage cash and other resources of the cooperative, efficient and timely receipts of revenues, meaningful cash forecast planning techniques, and the effective utilization of idle funds in liquid investments.

Financial management can be classified or subdivided into current day-to-day operations and the planning role. Current operations include major accounting policies, report interpretation, profit analysis, cash management, and investment management. The planning role gives consideration to organizational structure, budgets, protfit planning, capital expenditures and insurance requirements of the cooperative.

(1) Current Operations. In reviewing the accounting policies function of financial management, the auditor should evaluate the reasonableness of a particular policy in terms of established accounting principles of the National Credit Union Administration and the possibility of improvements.

The function of report analysis deals with the various types of reports prepared and the purpose of these reports. In reviewing the report function, the auditor should consider whether the existing reports satisfy

operational requirements of the cooperative and the needs of users. Attention should also be given to management's analysis of the reports and their role in management decisions.

The general objective of profit analysis is acquiring additional information on current operations to include identifying the causes of changes in trends, comparison of actual results with planned results, and the analysis of alternatives. To review the profit analysis function of the cooperative, the auditor is concerned with specific methods utilized and determing if these methods are adequate for managerial decision making.

The cash management function is the focal point for management of working capital. This function includes management of loans, inventories, investments, and payables which affect the liquidity of the entity. It involves the most efficient utilization of cash after normal daily requirements. Cash management is concerned with the investment of surplus cash to maximize earnings of the cooperative and control of regular cash flows to minimize potential disruption in daily operations.

Control points in the cash management function which the auditor must address are the prompt transfer of cash balances, to insure that funds in excess of minimum required balances are invested, and that control over disbursements is maintained to insure timely payments of liabilities.

An additional key point in controlling the cash flows of the cooperative is development of a cash budget to identify and summarize the sources and flows of cash. The auditor should ascertain if a cash budget is prepared and analyze alternative courses of action that could be taken to eliminate any potential problems.

The investment function is concerned with available cash beyond reasonable reserves being invested in interest-bearing notes or securities. In this function, the auditor is concerned with the cooperative satisfying National Credit Union Administration requirements for reserves and the established profit plan of the cooperative. Additionally, the auditor must review each investment to determine if security and liquidity requirements are maintained.

(2) Planning Role. The final function of financial management concerns planning conducted and the development of a profit plan. A budget can assist the cooperative in achieving improved planning of its current operations. If properly developed a budget provides an opportunity to evaluate the effectiveness of current operations and to develop plans for improving future operational results. A budget also provides a major basis of control for management. The internal auditor's concern in the budget function is the total budget procedure. It includes basic policies and procedures, the scope of instructions issued, timing, coordination of efforts, the final product, and the review process.

Planning and control of capital expenditures is concerned with major prerequisites for expanded operations, new services to be provided, and the cash needs related to such decisions. The internal auditor's role in review of this function includes an evaluation of the adequacy of budgets and scientific methods used in the decision process. Additional concerns are the identificaiton of long-term capital needs and satisfaction of short-term capital requirements of the cooperative.

Insurance represents the final function of financial management. This function is the most basic sense a major part of the total cooperative effort to manage risk. The auditor's concern is that adequate surety bonds are maintained and that the cooperative is covered against all relevant insurable hazards.

The second section of Exhibit V-2 is the audit program for the financial management activity of fiscal administration. <u>This audit guide must also be tailored to the specific cooperative being audited</u>.

EXHIBIT V-2

FISCAL ADMINISTRATION

BASIC FINANCIAL CONTROL

1. Background Information
   - A. Obtain list of employees who handle cash.
   - B. Scope of chart of accounts and description of individual accounts.
   - C. Policies and procedures relating to these areas:
     1. Cash processes: receipts, disbursements, custody, petty cash fund, branch funds, and administration of bank funds.
     2. Payable processes: vouchering, internal review procedures, records, special payables, travel expenses, accruals, and notes payable.
     3. General procedures: types of records, reports, and operational aspects.
     4. Fraud: prevention and handling of actual developments.
   - D. Dividend policy
   - E. Operational arrangements with other financial organizations.
   - F. Handling of deviations.
   - G. Cash flow chart from collection from member to deposit in bank and recording on members statement.
   - H. Review previous financial control audit reports.

2. Cash Receipts
   - A. Are cash received vouchers properly prepared when members make payments or deposits to the cooperative?
   - B. Do members receive receipts for payments or deposits made to the cooperative?
   - C. Are cash receipts balanced daily and entered in the Journal and Cash Record as of the day on which they are received?
   - D. Are cash over and short items recorded accurately each day, and are such items reviewed at least monthly by the board of directors?
   - E. Are all cash receipts accounted for in the period(s) sampled?
   - F. Is the cash account reconciled each month with the balance reported by the bank?
   - G. Are cash received vouchers prepared properly and summarized daily?
   - H. Does someone other than the teller take deposits to the bank?
   - I. Are duties of tellers entirely separate from recording transactions on member's accounts?

3. Cash Handling
   A. Are physical safeguards adequate at all stages?
      1. Do employees utilize their own lockable cash drawer or cash box?
      2. Do tellers have bait money?
      3. Are spare keys to cash drawers or boxes kept under appropriate control?
      4. Are change funds maintained in amounts authorized by the board of directors and are they replenished in the manner prescribed by the Accounting Manual?
      5. Are adequate precautions taken to prevent cooperative funds from being comingled with personel funds or other funds under control of the employees?
   B. Is cash on hand - in all forms, at all levels, and for all purposes - at the lowest possible level?
   C. Are adequate safekeeping facilities provided for all cash and other liquid assets in custody of the cooperative?
   D. Are cashiers/tellers instructed to stamp a restrictive endorsement immediately upon receipt of a member's check?
   E. Are bank deposits prepared by an official or employee who does not serve as a teller?
   F. Are bank deposits made intact within the time limits prescribed in the bylaws? ("Intact" refers to all cash collections and checks received in the period covered by the deposit deposited together.)
   G. Is accountability established and maintained for traveler's checks and money orders?
      1. Are they inventoried regularly?
      2. Are serial numbers recorded and utilized in the inventory process?
   H. Are periodic surprise cash counts made?
      1. Is the process documented?
      2. Is a random day for the count selected?

4. Cash Disbursements
   A. Are petty cash funds utilized and operated on an imprest basis?
   B. Are standards adequate for documentary support? If not, why not? Appraise also the standards of review at the time of disbursement.
   C. Are all cancelled checks signed properly and did all endorsements appear to be proper?
   D. Were all disbursements examined made in accordance with the procedures prescribed in the Accounting Manual for Federal Credit Unions?
   E. Are confirmation letters mailed to all banks with which the cooperative has accounts?
   F. Have expenses been properly authorized by the board or executive committee?

G. Are expenses supported by appropriate vouchers or invoices?
H. Have dividends been properly authorized by the board of directors?
I. Are dividends computed in accordance with the Federal Credit Union Act, the bylaws, and the Accounting Manual?
J. Are disbursements made by check or in accordance with disbursement procedures authorized by the board of directors, and are such disbursements properly recorded in the records?
K. Do the directors or executive committee minutes contain a record of employees authorized to sign cooperative checks?
    1. Are adequate measures taken to prevent checks from being signed or countersigned in blank?
    2. Are invoices and other supporting documents attached to checks prior to checks being signed?
    3. Are paid invoices and bills marked paid with the date of payment to prevent more than one disbursement from the invoice or bill?
    4. Are spoiled or voided checks properly accounted for and retained?
L. Are share withdrawals by borrowers and comakers approved by the credit committee or loan officer as specified by the bylaws?
    1. Are the individual share and loan ledgers posted through the last month-end?
    2. Are monthly trial balance tapes or listings or individual share and loan ledgers prepared each month?
    3. Is the general ledger in balance?
    4. Record the balances of the general ledger and compare with the committee's trial balance tapes. Note the differences and ascertain how long ledgers have been out of balance and why.
M. Are loans disbursed only after completed and signed applications have been approved by the credit committee or loan officer?
    1. Are properly signed notes on hand in support of loans?
    2. Are adequate measures in effect to prevent loans being disbursed by the loan officer who approved the granting of the loan?
    3. Are loans to members on the board of directors, credit committee, and the supervisory committee acted upon by the board of directors?
N. Are withdrawals from inactive share accounts verified by an official other than the official or employee making the disbursement?

O. Are bank reconciliations prepared monthly by persons not directly concerned with handling cooperative funds and recording them on the records?
P. Does the supervisory committee periodically obtain bank statements directly from the bank and reconcile them with the records of the cooperative?

5. General
   A. Are employees who handle or have any direct or indirect access to cash adequately bonded?
   B. Are independent work assignments in effect to the extent practicable, including the reconciliation of bank accounts?
   C. Are officials and employees who handle or have access to funds and securities and who maintain records required to take vacations at least annually?
      1. Are employees trained to perform each other's duties?
      2. Is possession of the combination for unlocking the safe limited to no more than two individuals?
      3. Is the combination to the safe changed when an employee having knowledge of it leaves the employment of the cooperative?
      4. Are door locks changed each time a person with access to the key leaves the employment of the cooperative?
   D. Perform a cash count to insure the disclosure of questionable items if they exist.
   E. Are records of accountability separately maintained?

6. Payrolls
   A. Are independently prepared personnel department records used properly as cross controls for the preparation of payrolls?
   B. Review and appraise the effectiveness of the primary procedures and records by which the record of work is accumulated and validated.
   C. Review and appraise the procedures by which payroll data are processed, authorized deductions made, payrolls finalized, and checks prepared.
   D. Are the procedures for payment adequate to assure the release of checks to the proper individuals without the opportunity for diversion or modification?
   E. Are payroll computations checked by someone other than the person who prepares the check?
   F. Are the current tax withholding tables being used and tax payments being made when due?
   G. Are there signed W-4 forms on file for each employee?
   H. Are the time cards supporting pay earned approved by the appropriate supervisor?

I. If income and FICA tax witheld exceeds $200 in a calendar month, is the cooperative making the required monthly deposit?

7. Basic Accounting Activities
   A. Are primary papers, journals, ledgers, auxiliary records and reports, adequately structured and administered in connection with the various accounting activities, and in a collective sense?
   B. Review and appraise the operational effectiveness of the basic accounting activities - again in connection with particular financial processes and in total - as to:
      1. Distribution of work assignments.
      2. Competence of personnel.
      3. Utilization of personnel.
      4. Effectiveness of coordination and support of other activity entities.
      5. Reasonableness of decentralization.
   C. Evaluate the basic accounting activities, as to:
      1. Cost of operation.
      2. Error experience.
      3. Fraud experience.
      4. Orderliness of operations.
      5. Recipients view as to service received.
   D. Is written authorization for a petty cash fund on file?
   E. Does the petty cash on hand plus receipts for disbursements equal the amount of the fund authorization?
   F. Do the expenditures vouchers for the petty cash fund reflect authorized purchases?
   G. Is written authorization for the change fund on file?
   H. Are amounts of the change funds reasonable?
   I. Are receipts being obtained when change funds are issued to tellers?
   J. Are proper physical safeguards and facilities employed to protect change funds?

8. Maintenance of Records
   A. Are all financial records of the credit union maintained in ink or by machine?
      1. Are all corrections in financial records made in such a manner that the changes can later be verified?
      2. Are the vital accounting records kept in a fire resistant container or containers?
   B. Are the minutes of the directors' and membership meetings:
      1. Prepared promptly in permanent form?
      2. Reflected accurately?
      3. Read and approved at the next meeting?

C. Are minutes of the credit committee meetings and reports of loan officer actions prepared promptly in permanent form?
D. Is the file of members' signature cards (applications for membership) maintained currently?
E. Are mailing addresses of members maintained up-to-date?
F. Are loan documents completed by ink or typewriter before signatures are added?
G. Is repossession and sale of collateral controlled and supervised by the board of directors and are the transactions involving such activity clearly reflected on the records in accord with the instructions in the Accounting Manual?
H. If the credit union uses window posting or teller machines:
    1. Does each teller have a key (teller's symbol) for his/her exclusive use?
    2. Is maximum utilization being made of the built-in control devices in the machine(s), such as locks, and keys, counter or dials, and teller's symbols?
    3. Is access to the machine by-product (journal or proof sheet) limited to supervisory personnel?
I. Is a list of new members and withdrawn members furnished to the board of directors and to the supervisory committee each month?
J. Are employees who are assigned to post specific blocks of members' accounts rotated from time to time?
K. Are monthly share and loan balance tapes prepared by employees other than those who post the accounts?
L. Is the balancing of share and loan accounts with General Ledger controls and the maintenance of the Journal and Cash Record and the General Ledger assigned to employees who do not serve as tellers?
M. Are share accounts in which there has been no activity (except dividends) for a year or more segregated from the active accounts?
N. Are the duplicate vital records stored on a quarterly basis in an off-site vital records center?
O. Is a Records Preservation Log maintained?

9. Fraud
    A. Appraise the extent to which the cooperative climate is attuned to fraud prevention rather than fraud detection.
    B. Are fraud potentials adequately studied both to prevent fraud and to protect individuals from excessive temptation?
    C. Are fraud developments systematically handled and also used as a basis for study of where procedures should be strengthened?

FINANCIAL MANAGEMENT ACTIVITIES

1. Background Information
   A. Review organizational chart for cash management.
   B. Evaluate cooperative's banking relations.
   C. Review forecasting and budgeting procedures.
   D. Review summary of cooperative's banking arrangements.
      1. Type of accounts.
      2. Compensating balances.
   E. Determine month-end balances for all major accounts.
   F. Obtain list of key personnel in the cash management function by position level and location.
   G. Review previous audit reports.
   H. Review cash management policies.
   I. Review profit policies.

2. Accounting Policy
   A. Review and appraise the manner in which major accounting policies are developed, including depth of study and adequacy of coordination.
   B. Appraise the adequacy of the scope of existing policies, including those applicable to:
      a. Capital and revenue expenditures.
      b. Deferments of expenses.
      c. Accruals of expenses.
      d. Creation of reserves.

3. Report Analysis
   A. Review and appraise the total group of financial reports regularly issued, with particular reference to:
      1. Focus on user needs.
      2. Ease of interpretation and use.
      3. Respect for individual managers responsibilities.
      4. Quality of analysis.
      5. Adequacy of attention to the future.
   B. Review the adequacy of analysis in the interpretation of financial reports.

4. Profit Analysis
   A. Review and appraise the existing program of profit analysis.
   B. Are adequate efforts made by management to recognize the limitations of profit analysis and to provide supplementary data?
   C. Are flexible budgets used to the extent practicable?
   D. Are incremental types of analysis utilized for guidance to management?

E. Is the total effort adequate, in the way of developing various types of profit analysis?

5. Cash Management
   A. Is the importance of the cash management activity adequately recognized in terms of assigned responsibilities and quality of personnel?
   B. Are there written guidelines outlining the objectives, policies, standards, and procedures for the cash management function?
   C. Does the cash management function interact with other operating departments with respect to:
      1. Consideration of unforeseen cash requirements?
      2. Normal receipts/disbursements of funds?
   D. What steps have been taken to increase the availability of cash? Are they adequate?
   E. Is a cash budget regularly prepared and released to all interested parties?
      1. Have cash flows been studied for maximum possibilities of regularization?
      2. How effective is the program for the investment of surplus cash?
   F. Does the cooperative have appropriate charges for the cost of redepositing and reprocessing checks returned for insufficient funds?
   G. Are bank deposits made on a daily basis?
   H. Does the cooperative act in a timely manner to reconcile and settle discrepancies between amounts invoiced?
   I. Has the cooperative compared the cost of managing the cash function (payroll, etc) in-house with the cost of having a bank perform such functions?
   J. Are major disbursements deferred until the latest possible date?
   K. Are cash discounts taken?
   L. Are cash withdrawals avoided on Friday as a means of gaining week-end interest?
   M. Are the balances and number of imprest and change funds limited?
   N. Does the cash forecast list the significant sources and use of funds, taking into consideration changes in working capital?
   O. Does the cooperative use a short-term forecast in determining day-to-day needs?
   P. Is actual cash flow compared to forecasted?

6. Investments
   A. Has the cooperative developed formal directives regarding investment of funds?
   B. If so:
      1. Are specific responsibilities delineated?

2. Are specific procedures outlined?

C. Does the cooperative, by means of management reports or other such data, have an accurate idea of cash available for investments at any given time?

D. Does the cooperative perform periodic analyses of the yield obtained on available cash balances?

E. Do cash investments appear to be yielding a reasonable return?

F. Is income from investments accounted for properly?

G. Are investments properly authorized?

H. Do investments support the financial objectives of the cooperative?

I. Do investments support the requirements for liquidity. safety, and yield?

J. Do investment policies address both short- and long-term investments?

K. Are long-term investments properly analyzed for risk and changing money markets?

L. Does the board of directors provide definitive policy statements and clear-cut practices for the executive committee?
1. What investment to make?
2. When investments should be made?
3. When investments should be sold?
4. Does the committee provide the board with a monthly report on investments made and sold?

M. Are investments diversified?

N. Are investments restricted to government securities and other instruments issued by the government, loans to other credit unions, shares or accounts of federally insured saving and loan association or mutual savings banks, and shares or deposits in central credit unions and federally insured credit unions?

O. Is borrowing on behalf of the cooperative within limitations of the Act?
1. Is borrowing properly authorized?
2. Is interest on borrowed funds computed and accounted for properly?

P. Are confirmation letters mailed to all organizations where funds are invested and to all sources from which borrowed money was obtained?

Q. Has the cooperative considered the employment of idle cash for forward or strategic purchasing of equipment, supplies, or other regularly purchased items which are subject to dramatic price fluctuations?

R. Are investments pooled from all available funds to maximize return and reduce overhead charges?

S. Does the cooperative use state investment pools to obtain higher yield and greater flexibility in making investments?

T. Has the cooperative considered joint investments with other surrounding entities?

U. Does the minutes of the board, executive committee, or investment committee contain prior approval for changes in the cooperative's investments?

V. Are adequate safekeeping facilities provided for investment securities?

W. If investment securities are maintained in a safe deposit box, are at least two officers, acting jointly, required to gain access to the safe deposit box?

7. Planning

A. Annual Budget

1. Has top management established and provided adequate backing for a budgetary program. Appraise whatever is being done of an annual planning nature.
2. Is the responsibility for coordinating the development and later administering the budget placed at an adequate organizational level?
3. Is the organizational structure reasonably supportive of an effective budget program?
4. Is the planning aspect of the budget adequately emphasized?
5. Are there adequate procedures covering the manner in which budgets should be developed by the individual cooperative components?
6. Does the finance group provide adequate assistance through providing historical performance data, explaining procedures, and providing any other needed experience?
7. Are the budget data developed along the lines of accounting reports, so that budgetary performance can be periodically measured and evaluated?
8. Are individual budgets as developed accepted by the respective managers as their own commitments and plans?
9. Are existing gaps reconciled on a mutually satisfactory basis?
10. Review and appraise the extent to which interim performance reports are used for management analysis. What evidence is there of resulting corrective action?
11. Is a budget calendar utilized?
12. If so, does the calendar:
    a. Detail the completion dates for each phase of the budgeting process?
    b. Identify the organizational units involved in each phase of the process?
    c. Permit time for management review at each organizational level?

d. Reflect prior experience modified for anticipated events?
e. Provide flexibility to permit consideration of unforeseen events?

13. Does the general manager or budget officer monitor the budgeting process to ensure that each step is accomplished in a timely manner?
14. Is the budget prepared in accordance with cooperative requirements and consistent with the accounting structure?
15. Are estimates of revenue developed before the budget is formulated?
16. Are the revenue estimates supported by detailed analyses?
17. Have forms been developed for departments to use in preparing their expenditure estimates?
18. Are these forms compatible with the cooperative's overall budget approach to facilitate consolidation of the estimates into the final budget?
19. Are instructional packages sent to all departments in the initial stage of developing the expenditure budget?
20. Do instructional packages include:
    a. The budget calendar?
    b. A management statement concerning goals, policies, and expectations for the upcoming budget period?
    c. Instructions for completing the budget forms, including comments on required documentation?
    d. Analysis of the previous year's activities?
21. Does the management policy statement and related policy documents included in the budget package provide:
    a. A translation of broad goals and policies into detailed requirements for the various departments?
    b. Positive goals rather than negative ones?
    c. Measurement criteria?
    d. The general level of revenue and expenditures for the projected budget period?
    e. Estimates of expected cost reductions for the year by department?
    f. Organizational plans for new, improved, or expanded services?
    g. Notice of new administrative regulations and guidance in their application?
    h. Comments as to the impact of economic conditions on services and programs?
22. Do the department budgets include goals and objectives in line with those in the management policy statements?

23. Do the department budgets indicate how the goals and objectives should be measured?
24. Are the department programs and services consistent with these goals and objectives?
25. Is department workload data compiled and used to produce and support the budget request?
26. Are the budgets and supporting data received no later than the date designated in the budget calendar?
27. Are all budgets submitted reviewed by the budget officer or the general manager?
28. Is the final budget approved by the board of directors or the designated budget committee?
29. Is the board or budget committee active in the budget process?

B. Profit Plan
   1. Apply the same guides as listed under the annual budget to the review of the profit plan activity.
   2. Is the profit plan properly tied into the annual budget?
   3. Review and appraise the adequacy with which new profit plans are reconciled with previous profit plans.

8. Planning and Control of Capital Expenditures
   A. Capital Expenditure Budget
      1. Is a capital expenditures budget prepared? If not, appraise the extent of the existing need.
      2. Review and appraise the adequacy of the manner in which the capital expenditures budget is prepared and administered.
   B. Financial Evaluation of Capital Projects
      1. To what extent are methods used which adjust for the different time values of money?
      2. Are the results of these newer scientific methods adequately communicated to management?

9. Insurance
   A. Does the blanket surety bond comply with the minimum requirements?
   B. Does the board of directors review the amount of surety bond coverage in effect at least semi-annually to determine adequacy?
   C. Are all insurable hazards adequately covered by insurance?
   D. Are premiums paid currently on all insurance coverage?

Segments of this audit guide were developed from an audit guide presented in Modern Internal Auditing, by V. Z. Brink, J.A.

Cashin, and H/ Witt, New York: John Wiley & Sons, Inc., 1973, p. 359-363.

Additional material utilized to develop this guide included:

F. Pomeranz, A. J, Cancellieri, J. B. Stevens, and J. L. Savage, 1976, p. 123-129, and p. 153-159.

J. C. Robertson, Auditing, Dallas, TX: Business Publications, Inc., 1979, p. 396, 400, 411, 435, 439.

Supervisory Committee Manual for Federal Credit Unions, National Credit Union Administration, 1976, p. 58-60 and 94-95.

Preferred practices presented in Chapter II of this study.

2. Property Management

The overall objective of property management is concerned with the assurance that:

> . . .adequate equipment and supplies are available and are being used, controlled, maintained, and replaced in an economical manner [21:20].

Credit unions like most other organizations have substantial investments in inventory, furniture, and equipment as well as physical facilities. Due to the amount of funds involved, it is important that adequate control be maintained to prevent spoilage, pilferage, and general decay because of improper maintenance. Thus, the primary mission of effective property management is the receipt and control of equipment and supplies, the control of the use of facilities, equipment, and supplies, the maintenance of equipment and facilities and their security.

The purpose of the first function is to insure that the cooperative has the desired type, quality, and amount of equipment, supplies, and inventory available for use when required. The second function is concerned with the proper use of all available assets. The third function is directed at preventive and repair maintenance of equipment and facilities, to ensure that it is maintained at the least cost and is "operationally ready." The final function is concerned with establishing and maintaining effective and adequate security of the cooperative.

a. Receipt and Control of Equipment and Supplies

This function deals with the adequacy of the inventory control system, which in turn is concerned with the effectiveness of property records. The control points to be verified by the auditor in this function are concerned with designated responsibilities for property and taking a physical inventory of that property.

Verification of property records and a physical inventory is an indication of how well established policies actually work. Further, differences between the actual inventory and property records provide a basis for determining underlying causes for discrepancies. A physical inventory can also provide the internal auditor an excellent opportunity to learn a great many things concerning overall efficiencies of the cooperative. Particular concern for the auditor is the assigned responsibility for supervising inventory tasks and compliance with existing control procedures to safeguard inventory items.

b. Control of the Use of Facilities, Equipment, and Supplies

This function is centered around assuring the proper usability of assets held by the cooperative. The internal auditor should attempt to determine if assets are protected from deterioration through improper exposure and/or unauthorized use. Security, fire, and safety procedures of the cooperative are important factors for the auditor to review in determining the usability of facilities, equipment, and supplies.

The auditor should analyze whether tellers/clerks that operate assets have been properly trained and if they possess the necessary skill to properly operate the assets. The auditor might also consider whether the present equipment is operating up to expectations or if it could be replaced by less expensive equipment or more effective equipment.

c. Maintenance of Equipment and Facilities

This function deals with whether equipment and facilities are being maintained in a state that allows daily operation without detracting from efficient and effective cooperative activities. Proper maintenance of operating equipment can prevent more serious and expensive repairs. The key in this area for the auditor to examine is existing programs and procedures for maintenance of assets and identifying situations where policies are not being followed. The auditor must also consider whether maintenance of assets is more costly than the replacement costs for the asset.

d. Security Devices

Security devices and the documented security program for the organization represents a key area of concern for every cooperative.

In this function the internal auditor must ascertain if at least the minimum standards established by the NCUA and the board of directors are being satisfied. The auditor should review the installation, maintenance, and the daily operation of all security devices utilized by the organization.

Exhibit V-3 is the recommended audit guide for effective property management. This subprogram of the "single audit" guide recognizes the various aspects for adequate inventory control, security, and usability of facilities. However, all audit steps may not be appropriate to all cooperatives reviewed. An example of such an audit step, is whether the credit union needs or requir mathematical models to determine inventory ordering points.

3. Procurement

The overall objective for the auditor in the procurement function is to ensure that:

> "procurement involves planning, organizing, and managing to obtain goods and services in an efficient and economical manner" [14:161].

A typical procurement cycle involves the six major functions of: determination of needs, authorization, purchasing, follow-up, delivery, and financial settlement. Each of these functions have a control point that is essential for a smoothly operated cooperative.

a. Determination of the Need

> "the basic control issue in the determination of needs is the extent to which that determination is made on a sound basis and then accurately communicated to the purchasing group" [20:126].

Determinations usually include pre-determined economic order points for commonly stocked items to identify the best number of orders to be placed in a year and the dollar value of an optimal order. In the determination of need, key

EXHIBIT V-3

PROPERTY MANAGEMENT

1. Background Information
   A. Determination of ordering criteria.
   B. Receiving of materials into cooperative.
   C. Storage of materials.
   D. Release of materials from cooperative.
   E. Coordination with other branch components.
   F. Authorized level of approval.
   G. Handling of obsolete and damaged material.
   H. Handling of deviations from established procedures.
   I. Inventory records.
   J. Physical verification of inventories and book records.
   K. Review previous audit reports.

2. Determination of Needs
   A. Who is responsible?
   B. What is the basis of the determination?
      1. Is the coverage of pertinent factors adequate?
      2. Has the mathematical basis of existing models been backed up by adequate expertise? (Economic Order Quantities, etc,)
      3. Has it been approved by an adequate level of authority?
      4. Are acquisitions and disposals of assets authorized by the board of directors or executive committee and properly reflected in accounting records.
   C. Are the various types of materials adequately covered?
   D. What supplementary day-to-day approvals specified as the results of the designed approach are translated into actual procurement orders?

3. Current Operation of the Design for Determination of Needs
   A. How often is the basic design reviewed, and is this reasonable?
   B. Review the adequacy of input data used in the basic design.
   C. Review a representative number of individual inventory balances to ascertain the extent to which the basic design appears to be producing reasonable results. Have writeoffs for obsolete materials been reasonable?
   D. Are stipulated approvals being actually required?

E. Is the rate of depreciation on assets authorized by the board of directors or the executive committee reasonable?
F. Are all other assets and liability accounts maintained in accordance with instructions in the Accounting Manual for Federal Credit Unions?

4. Incoming Materials
   A. Are the items being handled adequate from a physical standpoint?
   B. Is security adequate?
   C. What are the procedures for handling damaged materials?
      1. Who is notified?
      2. Who authorizes rejection?
      3. How are materials segregated?
      4. How is disposition handled, and who is responsible?
   D. What are the procedures for handling overshipments?
      1. Who is notified?
      2. How are materials segregated?
      3. How are they disposed of?
   E. What are the procedures for handling valuable or specially attractive items?
   F. How are after-hour deliveries handled and reported?
   G. From the materials being held in the receiving department, a selection should be made to include, where possible:
      1. Materials which cannot be identified with purchase orders.
      2. Materials to be returned to vendors.
      3. Damaged materials.
      4. Materials being held for any other reason.
      5. Materials held for an undue length of time.
      The auditor should determine whether reporting, follow-up and other procedures are being followed.
   H. Are accountabilities being properly transfered through counts and sign-off of transfer papers?
   I. Are records promptly and accurately posted?

5. Storage of Materials
   A. Are facilities and equipment adequate?
   B. Is the overall approach sound for the location of specified materials?
   C. Are materials being promptly moved to assigned locations?
   D. Are storage areas orderly and is there adequate access?
   E. Is security adequate?
      1. Are there letters on file designating persons who have custody of keys to each space?
      2. Are individuals no longer employed by the cooperative required to turn in their keys?

    3. Are adequate fire and safety procedures in effect?
  E. Determine if supplies that are susceptible to deterioration are properly rotated to protect them against loss.
  F. Do book records show assigned locations?

6. Release of Materials
  A. Is collection of materials for release phase adequately handled:
    1. As to authorizing paper to collectors?
    2. As to care in collecting individual materials, both as to accuracy of count, and physical handling?
  B. Is the release procedure adequately handled:
    1. As to reasonable recheck of accuracy of collection?
    2. As to procedural transfer of accountability?
    3. As to posting of inventory records?
    4. As to adequacy of security?

7. Maintenance of Book Inventory and Property Records
  A. Are records properly maintained?
  B. Are abnormal book record developments adequately investigated?
  C. Are low stock developments used as alerts for checking on new supplies?

8. Inventories
  A. Verify that inventories are taken according to established cooperative policies.
  B. Test-count a sample of inventory items. Trace test counts to final inventory compilation.
  C. Vouch unit prices to vendors' invoices.
  D. Check physical counts with quantities recorded on the property records and investigate differences.
  E. Ascertain if the location on materials agrees with the property records.
  F. Vouch entries on the property records to their source documents.

9. Security
  A. Is a written security program being followed?
  B. Is a security officer been appointed?
  C. Has the security officer provided for appropriate maintenance and testing procedures for security devices?
  D. Are the security devices installed and in operation and procedures followed adequate?
  E. Are security devices in line with the cooperative's needs?
  F. Is a copy of the security program filed with the National Credit Union Administration Regional Director?

G. Has a Report on Security Measure, (Form NCUA 2360):
    1. Been prepared?
    2. Up-to-date and complete?
    3. On file with the regional director?

H. Has a certificate of compliance been completed and on file with the regional director?

I. Do security devices meet the required minimum standards?

10. Usability of Facilities

A. Are programs adequate to assure best possible operational use of various types of facilities?
    1. As to design of programs?
    2. As to extent programs are implemented with care, proper timing, and efficiency?

B. To what extent is there evidence of inadequate utilization of particular facility items?
    1. Buildings?
    2. Processing set-ups?
    3. Supporting equipment?

C. Are the various types of facilities reasonably protected from deterioration to which they are subject, considering costs of providing such protection?

D. Are policies for care and protection of facilities adequate?

Segments of this audit were developed from an audit guide presented in Modern Internal Auditing, by V. Z. Brink, J. A. Cashin, and H. Witt, New York: John Wiley & Sons, Inc., 1973, p. 166-169 and 257-262.

Additional material utilized to develop this guide included:

B. Cadmus, Operational Auditing Handbook, New York: The Institute of Internal Auditors, Inc., 1964, p. 250-254.

Supervisory Committee Manual for Federal Credit Unions, National Credit Union Administration, 1976, p. 59 and 95.

considerations are the general validity of the underlying need, quantities necessary, delivery requirements, and any other pertinent information concerning the purchase. An example of such additional information is the availability of discounts from vendors or the minimum quantity required to place an order.

In review of this function in the procurement activity, the internal auditor must evaluate the key considerations as to their significance in procurement of materials and their financial impact on the cooperative.

b. Authorization

Once the determination of the need has been established, the purchase must be authorized. The basic control issue in the authorization function is that a determination be made that the stocking of an item is in the best interests of the cooperative and in keeping with established policy.

The auditor must ascertain that each of these control points are satisfied and that the individual or official authorizing the purchase is acting within his/her designated responsibilities.

c. Purchasing

Making the purchase is the heart of the procurement function. It involves selecting the vendor, agreement upon a price, and making arrangements for delivery of the items ordered. The control points in question in this function is whether the market was fully exploited and the best possible price obtained.

The auditor must be sensitive to the diligence of search efforts for a vendor, negotiated prices and favoritism toward vendors.

d. Follow-up

After the purchase has been accomplished, the purchasing branch is concerned with the actual delivery of the items in accordance with the purchasing agreement. The control factor for this function is monitoring the performance of the vendor by the buyer and ensuring that needed materials are delivered in a manner which will satisfy cooperative requirements.

In review of this function, the auditor is concerned with the separation of responsibilities between the purchasing branch and the receiving branch to monitoring deliveries. Further, the auditor can review the formal follow-up record to appraise key performance dates.

e. Delivery

The delivery function is comprised of determination as to whether there has been proper compliance with the purchase agreement, or if not, what offsetting claims may exist.

The auditors job in this function is determining if inspections, tests, and/or item counts of deliveries are conducted prior to storage or issuing of the materials received. Key control aspects of the delivery is the

separation of duties of receiving and inspection activities from the purchasing group and that records of these activities are forwarded directly to the appropriate accounting activity.

f. Financial Settlement

The final function concerning the procurement activity of a cooperative is financial settlement. The control aspect of this function is the matching of the original purchase document with the receiving data and the authorization of payment to the vendor.

The auditors concern then, is ensuring that payments are authorized according to established policies and that materials were actually received. Further, the loss of discounts on purchases by not making prompt payments should also be explored.

Exhibit V-4 represents the procurement audit guide portion of the "single audit" program. The guide incooperates the six major functions discussed above into the key areas of authorization for purchase, internal operations, and relating vendors. This audit guide may contain specific audit steps that the supervisory committee may determine inappropriate for their internal review, however, it does provide an excellent guide to developing an appropriate audit program for their review.

EXHIBIT V-4

PROCUREMENT

1. Background Information
   - A. Review purchasing manual.
   - B. Review competitive bidding requirements.
   - C. Review extent of multiple sourcing.
   - D. Review extent of local purchases.
   - E. Review the coordination with user organizational components.
   - F. Review the authorized levels of approval.
   - G. Review the possibilities for conflict of interest and acceptance of gifts.
   - H. Review the handling of employee purchases.
   - I. Review the handling of deviations from established cooperative procedures.

2. Authorization for Purchase
   - A. Review the procedures for authorizing purchases. Points of special interest include:
     1. Who initiates?
     2. What approvals are necessary for particular types of items and amounts in terms of either quantities or dollar value?
     3. What forms are to be used?
     4. How are supplementary approvals handled when actual purchase cost exceeds original estimates?
     5. What provision for changes in specifications or quantities?
   - B. On the basis of actual tests, verify and appraise:
     1. The extent to which the procedures are complied with. (Where they were not complied with to any significant degree, what were the effects?)
     2. Do the procedures appear to be adequate?
     3. Where there are unusual authorizations in terms of types of products, quantities, source restrictions, etc., does it appear that these are questioned and discussed?
     4. Does the cooperative take advantage of specials?
     5. Does the cooperative buy in large lots in order to gain a reduced price on items purchased?
     6. Compare amounts and terms of invoices to payment vouchers to ascertain if discounts were lost.

3. Internal Operations
   - A. Are the facilities adequate:

1. For reception and interviews with vendor representatives?
2. For internal operations?

B. Are the internal operations being carried out in a manner consistent with established organizational responsibilities, policies, and procedures? If not, what are the effects, and what kind of corrective action seems to be warranted? This part of the review would include such questions as:
1. Should the organizational responsibilities be modified?
2. Should operational policies be reappraised?
3. Should operational procedures be revised?
4. Do we need different people?

C. To what extent do the operations reflect a high degree of efficiency and morale?

D. Are internal records and files of various types adequate in terms of special purpose and relation to other records and procedures? Are they being maintained efficiently?

E. Is the total purchase cycle adequately controlled as to the receipt of authorization, assignment to buyer, making of purchase, follow-up, and completion - so that the status of individual procurements can be easily determined?

F. Are purchasing forms properly safeguarded and controlled?

G. Are purchasing actions being processed on a timely basis?

H. Are verbal purchase orders confirmed by written confirmation purchase orders?

4. Relating to Vendors

A. Are adequate vendor records maintained showing supply capabilities and continuing purchasing relationships?

B. How adequate is the effort to develop new vendor sources?

C. How adequate are the field contacts with vendors to keep abreast of these vendor situations and to maintain high level cordial relationships?

D. What efforts are being made to evaluate vendor performance for price, delivery, and quality? Are adequate files pertaining to these factors maintained?

E. How adequate are the efforts to work with vendors to study cost reduction possibilities?

F. With respect to competitive bidding:
1. Are competitive bids solicited in all cases possible?
2. Are bids invited from at least three qualified vendors?
3. In the case of recurring purchases are competitive bids solicited with needed frequency?
4. Are all factors directly or indirectly related to price properly considered?

G. If price lists are used, are they updated with reasonable frequency?
H. Does the cooperative tend to stay with best sellers and name brands?
I. Is enough lead time allowed the purchasing agent to "shop the market."
J. Are there any indications that certain vendors receive favoritism?

Segments of this audit guide were developed from an audit guide presented in Modern Internal Auditing, by V.Z. Brink, J. A. Cashin, and H. Witt, New York: John Wiley & Sons, Inc., p. 139-143.

Additional material utilized to develop this guide included:

F. Pomeranz, A.J. Cancellieri, J. B. Stevens, and J. L. Savage, Auditing in the Public Sector, New York: Coopers & Lybrand, 1976, p. 173-179.

B. Cadmus, Operational Auditing Handbook, New York: The Institute of Internal Auditors., 1964, p. 76-82.

4. Personnel

The overall objective of a personnel function is to:

> . . .identify people with management potential early in their careers; to encourage the growth and development of all employees: to provide jobs that enable the jobholder to experience a sense of satisfaction and achievement; and to supply the organization with a continuing supply of competent, imaginative, well qualified management people [14:132].

This section provides the audit guide for the supervisory committtee to utilize in conducting an internal review of personnel. It treats the management of employees, which includes monitoring work performance, maintenance of personnel records, recruiting, training, and development. The effectiveness in a cooperative is largely dependent on the quality and responsiveness of the employees who carry out operations. The importance of employees as a factor in efficient operations of a cooperative and the magnitude of labor costs make it essential that human resources be employed effectively.

The audit guide reflected in Exhibit V-5 contains the four major sections of: personnel structure, recruiting and hiring, training and development, and performance appraisal.

a. Personnel Structure

Prior to recruiting employees the cooperative must identify its manpower requirements. This usually requires the development of a position classification system.

> "A position classification system defines particlar jobs in terms of the functions and responsibilities they entail [14:132].

EXHIBIT V-5

PERSONNEL

1. Background Information
   A. Review organization chart.
   B. Review data on number of employees working for the cooperative.
   C. Review summary of personnel costs.
   D. Review summary of employee turnover rate.
   E. Obtain a roster of key personnel including name, position, and location.
   F. Review policies and procedure manuals.
   G. Review position descriptions.
   H. Review previous personnel audit reports.

2. Personnel Structure
   A. Does the cooperative have a personnel department?
      1. Are clearly established goals and objectives defined?
      2. Are criteria established to measure their accomplishment?
   B. Are results achieved by the department:
      1. Documented?
      2. Compared to goals and objectives?
   C. Are lines of authority and responsibilities clearly defined in the department?
   D. Are personnel policies written and clearly defined?
      1. Is the board of directors or the personnel committee active in establishing personnel policies and procedures?
      2. Are personnel policies reviewed and updated by the directors or the personnel committee?
   E. Are personnel policies adhered to?
   F. Are position descriptions utilized?
   G. Does the position descriptions include:
      1. Performance requirements?
      2. Salary ranges?
      3. Assignment of specific duties?
      4. Identifying supervisors?
      5. Position qualifications?
   H. Are position descriptions periodically reviewed and updated by the department and operating managers?
   I. Are applicable laws, regulations, and union contracts adhered to?
   J. Has the department projected the cooperative's short- and long-range personnel needs?

K. Do projected personnel needs give consideration to:
   1. Short-and long-range plans of each department?
   2. Attrition?
   3. Promotions and transfers to other departments?
   4. New skills that may be required?
   5. Transfers or other dispositions of excess employees?
   6. Innovations that may reduce personnel needs?

L. Are personnel pools utilized for seasonal, emergency, and temporary assignments?

M. Are personnel records adequate in terms of design, and are they efficiently maintained?
   1. Are files kept up to date and available for current reference?
   2. Are job action changes - transfers, promotions, merit increases, new hires, terminations, and the like - promptly processed?
   3. Is access to the files restricted.
   4. Do files contain adequate emergency data including next of kin and appropriate phone numbers?

N. Does the department conduct termination interviews with employees?
   1. Are these reports maintained in personnel files?
   2. Are these reports reviewed by management officials and/or the personnel committee?

3. Recruiting and Hiring

A. Is recruitment centralized and/or coordinated properly to avoid duplication of effort?

B. Review and appraise the procedures followed for the various types of recruitment.
   1. Do organizational components being served participate adequately in the final selection?
   2. Are department heads satisfied with service being provided? If not, why not?
   3. Are records and files relating to recruitment being efficiently maintained?
   4. Are applications for employment when a position is not available maintained for future reference?

C. Does the recruiting system provide for:
   1. Use of position descriptions?
   2. Use of financial advancement as incentive?
   3. Consideration of present employee to fill open positions through promotion or transfer?
   4. Contact with educational, professional, and vocational agencies to seek qualified applicants?
   5. Public announcement of positions available?
   6. Controls to ensure compliance with applicable laws and regulations as well as the personnel budget?

7. Final review and approval by management?
8. Documentation of the process?

E. Are pertinent federal, state and local employment regulations adhered to?

F. Are new employees given a medical examination?

4. Training and Development
   A. What is the nature and scope of the training program?
   B. To what extent do other cooperative line and staff managers participate:
      1. By demonstrating support for the program?
      2. By actually participating in the instruction and training?
   C. Are cooperative organizational components satisfied with the training being provided? If not, why not?
   D. Are personnel being trained satisfied with the training experience? If not, why not?
   E. Does the cooperative have an orientation program for new employees? If so does the program include?
      1. A general description of the program and how the new employee relates to the total program?
      2. An adequate description of job specifications?
      3. A description of administrative requirements (work hours, timekeeping procedures, etc.)?
      4. A description of duties?
      5. Formal training if required?
   F. Does the personnel/training department follow up on the performance of new employees to determine if they are achieving job standards?
   G. Do present employees meet the stated job specifications?
   H. Are periodic staff meetings conducted to keep employees informed of cooperative activities?

5. Performance Appraisal System
   A. Do adequate evaluation forms exist for use at the various levels of organizational responsibility?
   B. Are policies and procedures reasonably adequate?
      1. Are reviews required periodically?
      2. Are reviews discussed with and approved by the next level of supervisory responsibility?
      3. Is there adequate evidence of the communication of review results to the affected employee.
      4. Are employees satisfied with the adequacy of the reviews being conducted by their superiors?
   C. Are evaluations available for later reference, and are they being used adequately for manpower planning?
   D. Does the personnel department monitor and follow up on:
      1. Absences?

2. Execessive time off?
3. Chronic lateness?
4. Failure to work a full day?
5. Actual or expected vacancies?

E. Are error rates established for each job?
F. Are evaluations of employees made on the basis of existing criteria of performance requirements?
G. Are job assignments consistent with job descriptions?
H. Have employee conduct standards been established and communicated to all employees?

6. Health and Safety
   A. Is the scope of the health and safety program adequate?
   B. Does the cooperative have a formal safety reporting system?
   C. Does the cooperative have:
      1. A fire-prevention program?
      2. A fire-drill schedule?
      3. A sufficient number of fire extinguishers?
   D. Are employees covered by workman's compensation or similar plans?

7. Employee Benefits
   A. Does the cooperative have a hospitalization and group life insurance plan for employees?
   B. Does the cooperative have a retirement plan for employees?
   C. Have policies for vacations, sick leave, and other benefits for employees been established?
   D. Are policies and benefits reviewed and updated?
   E. Is compensation and other fringe benefits available to employees equitable to those offered by other cooperatives?

Segments of this audit guide were developed from an audit guide presented in Modern Internal Auditing, by V.Z. Brink, J. A. Cashin, and H. Witt, New York: John Wiley & Sons, Inc., 1973 p.320-324.

Additional material utilized to develop this guide included:

F. Pomeranz, A. J. Cancellieri, J.B. Stevens, and J. L. Savage, Auditing in the Public Sector, New York: Coopers and Lybrand, 1976, p. 139-147.

Supervisory Committee Manual for Federal Credit Unions, National Credit Union Administration, 1976, p. 95-96

Preferred practices presented in Chapter II of this study.

The established system should reflect management's judgement as to how tasks should be divided up and responsibilities of employees at all levels. The system should be managed by a personnal department which periodically updates and reviews each position classification. The auditor's review should include an evaluation of the effectiveness of the system and ascertaining if the personnel needs of the cooperative are being fulfilled.

b. Recruiting ahd Hiring

The recruiting process begins by defining cooperative personnel needs, positions to be filled, and skill levels required. Further, care must be taken to ensure available positions are filled with the best-qualified individual. Typical approaches to the process include completing application forms, providing references, evaluation tests, and personal interviews. The auditor's concern in the recruiting and hiring audit is that all qualified applications have an equitable chance for employment and that appropriate policies or procedures are in effect and followed.

c. Training and Development

A cooperative cannot afford to ignore the educational and career development needs of its employees if it is striving to operate efficiently. The cooperative should have an orientation program for new employees that relates the employee to the complete organization. Further, standard procedures should be developed that familiarize the employee

with administrative policies and procedures of the cooperative as well as acquainting them with the specific requirements of their job. The concern in the review of training is that training needs of the cooperative have been identified and that an evaluation of training conducted is measured against that objective. Therefore, the overall objective of training and development is the achievement of greater usefulness and increasing the capabilities of employees.

d. Performance Appraisal

The appraisal of an employee's performance provides a basis for determining the future utilization of the individual and also assists the supervisor in helping the employee to overcome any existing limitations, thereby increasing the overall competence of the employee. A key problem in a performance evaluation system is that most managers prefer not to evaluate employees or not to explain their evaluation of the employee, which greatly reduces the potential benefit of the process. In review of the performance evaluation system, the auditor should insure that objective evaluations are being conducted in accordance with cooperative policies and that results of evaluations are reviewed with employees.

5. Operational Activities

This subprogram represents the final portion of the "single audit" program for the internal auditor. Exhibit V-6 was designed to assist the supervisory committee in conducting an internal review of both loan and delinquent loan policies, reserves, services to members, and the verification of members' accounts. This guide can be utilized by the internal auditor to ensure that the cooperative is in compliance with all legal and regulatory requirements which effect the cooperative.

a. Loans

In view of the basic purpose of a credit union and the fact that a large bulk of the cooperative's assets are in the form of loans to members, the internal review of loans is one of the most important tasks of the auditor.

Loan documents and other supporting data must be reviewed by the auditor to ensure conformance with limitations such as amounts outstanding, authorized payment periods, and interest rates charged. A review should also be conducted of loan applications for completeness, credit checks, and computations of the applicant's total monthly debt payment ratio. The auditor should explore the adequacy of collateral and compliance with nondiscriminatory practices in lending.

b. Delinquent Loans

In review of outstanding loans the internal auditor must examine the month-end delinquent loan schedule

to ascertain that all delinquent loans have been recorded. Further, the internal auditor must determine if accurate monthly delinquent loan schedules have been prepared and that these schedules are forwarded to the board of directors. Since delinquent loans can effect the sound financial base of the cooperative, the auditor must appraise current collection policies and determine if all possible actions are being taken to recover cooperative funds.

c. Reserves

The key in review of this function is ascertaining whether reserves are being maintained at a level that provides maximum protection to member's shareholdings. The auditor must determine if the cooperative has sound lending policies, strictly supervised collection policies, the maximum amount of funds working in sound loans to members as well as investments, and that additional reserves are maintained to conserve a positive financial structure.

d. Services of Members

The membership of a cooperative is the "life blood" of the organization. Here the auditor must determine if adequate services are being provided and if the needs of the membership are being served. The auditor must evaluate whether members are being informed of cooperative activities and if they are active supporters of the entity. The auditor can gain many insights to actual operations of the cooperative through interviews with members.

e. Verification of Member's Accounts

This function is also an essential portion of the internal review. The verification of member's accounts provides a check on the completeness and accuracy of cooperative records, protects the interests of members, and aids in deterring and detection of dishonesty.

The key aspect to this function is determining that there is a ledger account for every member and that the balance of the account corresponds to the member's record of funds deposited.

EXHIBIT V-6

OPERATIONAL ACTIVITIES

1. Background Information
   A. Review loan policies.
   B. Review interest rates.
   C. Review organization chart for loan approval.
   D. Review financial objectives of the cooperative.
   E. Review delinquent loan policies.
   F. Review charged-off loan policies.
   G. Review schedule of delinquent loans.
   H. Review balances in reserve accounts, allowance for loan lossess, and undivided earnings.
   I. Review previous audit reports.

2. Loans
   A. Are all loans supported by properly executed notes and loan applications?
   B. Are loans properly screened to prevent overextensions of credit?
   C. Are loans adequately secured by collateral?
   D. Are loans granted within limitations prescribed by the Federal Credit Union Act, bylaws and Rules and Regulations of the National Credit Union Administration?
   E. Are loans approved and recorded in the credit committee's minutes and records of the loan offices.
   F. Are loan interest charges correct?
   G. Have interest refunds paid been properly authorized by the board of directors?
   H. Were interest refunds computed in accordance with the Act, the bylaws, and the Accounting Manual for Federal Credit Unions?
   I. Are loan policies tailored to member's needs and cooperative desires?
   J. Are loan policies coupled with long range financial objectives of the cooperative?
   K. Are loan policies established by the board followed?
   L. Do interest rates charged on loans conform to the cooperative's financial objectives?
   M. Do interest rates ensure equitable treatment of shareholders and borrowers?
   N. Are variations from uniform interest rates based on standards equitable to all members?
   O. Does the credit committee meet monthly?

P. Do loan officers provide a record of all loan applications approved and disapproved to the credit committee within seven days of the application?

Q. Does the credit committee review all loans disapproved by loan officers?

R. Does the credit committee or loan officers ensure loans are for legal purposes?

S. Are the qualifications of members for loans determined prior to approval of applications?

T. Does the credit committee and/or loan officers counsel members on the wise use of credit?

3. Delinquent Loans

A. Are the cooperative's month-end delinquent loan lists substantially correct?

B. Are collection procedures established by the board of directors effective?

C. Is a complete and accurately classified report of delinquent loans prepared each month and reviewed by the board or the delinquent loan committee?

D. Does each monthly Statistical Report contain an accurate and complete classification of delinquent loans?

E. Does the supervisory committee confirm the outstanding balances of loans of delinquent borrowers in the hands of collection agencies or attorneys?

F. Does approval for the charge-off of each loan determined to be uncollectible by the board or executive committee appear in the minutes?

G. Are charged-off loans reviewed by the board or the executive committee at least semi-annually?

H. Are reports on recoveries of charged-off loans regularly made to the board or the executive committee?

I. Are delinquent loans "aged" and reported to the board?

J. Are written-off loans kept in a memo ledger or credit report file for access.

K. Are loan payments not made on time followed-up within five to ten days?

L. Are loan payment extensions only granted when members provide adequate explanations?

M. Are all possible legal steps taken to regain funds loaned to members who have delinquent accounts?

N. Are procedures established to ensure that members with delinquent loans are not granted additional loans?

4. Reserves, Allowance for Loan Losses, and Undivided Earnings?

A. Are the Regular Reserve, Liquidity Reserve, Allowance

for Loan Losses, and other reserve accounts maintained in accordance with the requirements of the Federal Credit Union Act, Rules and Regulations, and the Accounting Manual for Federal Credit Unions?

B. Do the board or executive minutes reflect authorization for all loans charged-off to the Allowance for Loan Losses?

C. Is the balance in the Allowance for Loan Losses acceptable with the number of loans outstanding?

D. Does the board or executive committee endeavor to collect charged-off loans?

E. Is the Undivided Earnings Account maintained in accordance with the requirements of the Accounting Manual for Federal Credit Unions.

F. Do any of these accounts disclose adverse trends?

5. Membership

A. Are adequate and appropriate efforts made on a continuing basis to keep members informed concerning the:

1. Purpose of the cooperative?
2. Progress of their cooperative?
3. Purpose and importance of the account verification by the supervisory committee?
4. Duties of officers, directors, and committeemen?
5. Important changes in policies, procedures, and hours of operations?
6. Is a membership letter prepared at least semiannually?

B. Are complete financial statements posted each month where they may be read by members?

C. If passbooks are used, are members required to retain their own passbooks and present them when transacting business at the cooperative?

D. If statements of accounts are used, does the supervisory committee investigate incoming mail to the cooperative shortly after statements have been distributed?

6. Verification of Members' Accounts

A. Is there a ledger account for every member?

B. Are individual ledgers in agreement with control accounts in the General Ledger?

C. Are control accounts part of a balanced General Ledger?

D. If individual ledgers are out of balance with the control accounts are records maintained until the initial verification process is completed?

E. Does the supervisory committee maintain control of verification letters, cards, statements, or passbooks until they are mailed or delivered to the members?
F. Is communication between the members and the supervisory committee direct?
G. Is the mailing or delivery of verification cards, letters, or etc., made by the committee?
H. Are all returned verifications under exclusive control of the supervisory committee?
I. Does the committee acknowledge inquiries within 30 days of receipt and have inquiries resolved within 90 days?
J. Is general notice of verification given to alert all members?
K. Does the supervisory committee maintain a confidential record of members' accounts?
L. Are all closed accounts verified?
M. If the confidential list is discontinued by the supervisory committee are substitute alternative control procedures adequate?
N. Is a record of account verifications maintained?
O. Do members contact the supervisory committee rather than operating personnel in the event of discrepancies in their accounts?
P. Is verification conducted by surprise contact with operating personnel and physical control of records?
Q. Is the Treasurer or other operating personnel not used in the verification program?
R. Is a trial balance taken of members' ledgers by the committee or its auditing assistants?
S. Is a record of (verified) members' accounts maintained by the supervisory commiteee.

7. General
   A. Does the supervisory committee confirm transactions involving life savings and borrowers insurance claims, with the insurance company and the beneficiaries?
   B. Are the manuals and instructional materials furnished by the National Credit Union Administration made accessible to officials for reference and study?
   C. Are these manuals and instructional materials utilized?
   D. Are annual and special audit reports reviewed and discussed by the board of directors promptly after completion?
   E. Is general management involved in this review and discussion?

F. Is the action taken by the board of directors on recommendations made by internal auditors and Federal credit union examiners recorded in the minutes?
G. Has corrective action been taken on all exceptions disclosed in previous audits?
H. Are all required financial statements prepared accurately each month?
I. Does the board of directors hold meetings at least monthly?
J. Are adequate minutes maintained of meetings of the members, the board of directors, the executive committee, the investment committee, and the credit committee?
K. Are adequate measures taken to minimize exposure to robbery and burglary?
L. Are employees instructed on what to do if a robbery occurs?
M. Are balances in members' share draft accounts, share certificate accounts, individual retirement accounts, and trust accounts verified?
N. Are the loan protection insurance and life savings insurance programs reviewed and appraised as to their adequacy?
O. Is the financial counseling of members by the cooperative adequate?
P. Are policy statements established by the board of directors maintained in a policy control record in the minutes of the board?
Q. Are written policy statements forwarded to all employees, members, and committees?
R. Are specific objectives of new policies identified?
S. Is accountability by new policies established by the board?
T. Are new policies reviewed as to their adequacy in meeting the objective?

Segments of this audit guide were developed from the _Supervisory Committee Manual For Federal Credit Unions_, National Credit Union Administration, 1976, p. 59-61, 95-96, 35-48.

Additional material utilized to develop this guide included:

Preferred practices presented in Chapters II and III of this study.

D. SUMMARY

This chapter has explained the elements of criteria, cause, and effect in defining an adequate audit objective. Further, the preliminary survey, detailed examination, and report development phase of an internal/review were also presented. Finally, the chapter presented the "single audit" program for credit unions which was comprised of the five subprograms of fiscal administration, property management, procurement, personnel, and operational activities.

Chapter VI will utilize the personnel subprogram developed in this chapter to perform a management audit of one of the sampled cooperatives.

VI. FIELD TEST OF THE MODEL

A. INTRODUCTION

During the period 30 January 1981 through 19 March 1981, an economy and efficiency audit of a local Federal credit union's personnel practices, procedures, and policies was accomplished by the author and LT. W. T. MINGES, USN, in accordance with standards for auditing in the public sector as set forth by the United States General Accounting Office (GAO) [27].

The purpose of this chapter is to discuss major elements of the audit leading to the results and recommendations formally presented to management officials of the cooperative on 19 March 1981. The audit results and recommendations presented herein were derived by utilizing the personnel audit guide portion of the "single audit" program developed in Chapter V.

B. SCOPE OF AUDIT

In conducting the management audit, the audit team directed its efforts toward determining the primary reasons that contribute to high personnel turnover at the cooperative and the costs associated with the turnover. Specifically, the audit was concerned with the following areas:

1. Review of personnel policies and procedures.

2. Organizational structure of the cooperative.

3. Personnel turnover experienced by the cooperative in 1980.

The audit was tempered by the fact that the audited cooperative had experienced rapid growth during recent years. This growth did not, however, allow for development of a formal personnel department, and the audit examined the areas of personnel policies, procedures, and organizational structure where improvements were within the capabilities of management. The scope was developed through personal observation and discussions with management.

C. SUMMARY REPORT OF PRELIMINARY SURVEY

1. Objective

The preliminary survey objective of the review was to obtain background and general information on all aspects of the cooperative's process involving personnel policies, procedures, and practices.

2. Scope

To reach the objective of the preliminary survey phase, the audit team reviewed the established personnel policies and procedures, the cooperative's organizational structure, job classification system, wage scales, and employee fringe benefits. Additionally, the cooperative's recruiting, hiring, training, and employee evaluation programs were analyzed.

3. Work Performed

Identification of the cooperative's organizational structure for the personnel function and familiarization with the entity's personnel policies, procedures, and practices were accomplished through a series of interviews with management officials as follows:

Date	Personnel Interviewed
30 January 1981	General Manager Assistant General Manager
12 February 1981	General Manager Assistant General Manager
2 March 1981	Assistant General Manager

4. Results Achieved from the 30 January 1981 Interview [2_:A-1.I.I].

a. Primary Point of Contact

Management officials and the audit team agreed that, based on the objective and scope of the audit, the Assistant General Manager of the cooperative would serve as the primary point of contact for the review. However, all parties recognized that considerable involvement of each Branch Manager would also be required.

b. Concern of Management Officials

During the course of this initial interview with the auditors, both the General Manager and the Assistant General Manager expressed concern for the high turnover in personnel that the credit union experienced in 1980. They

were also concerned about the effect of this turnover on training costs and the efficiency of employees.

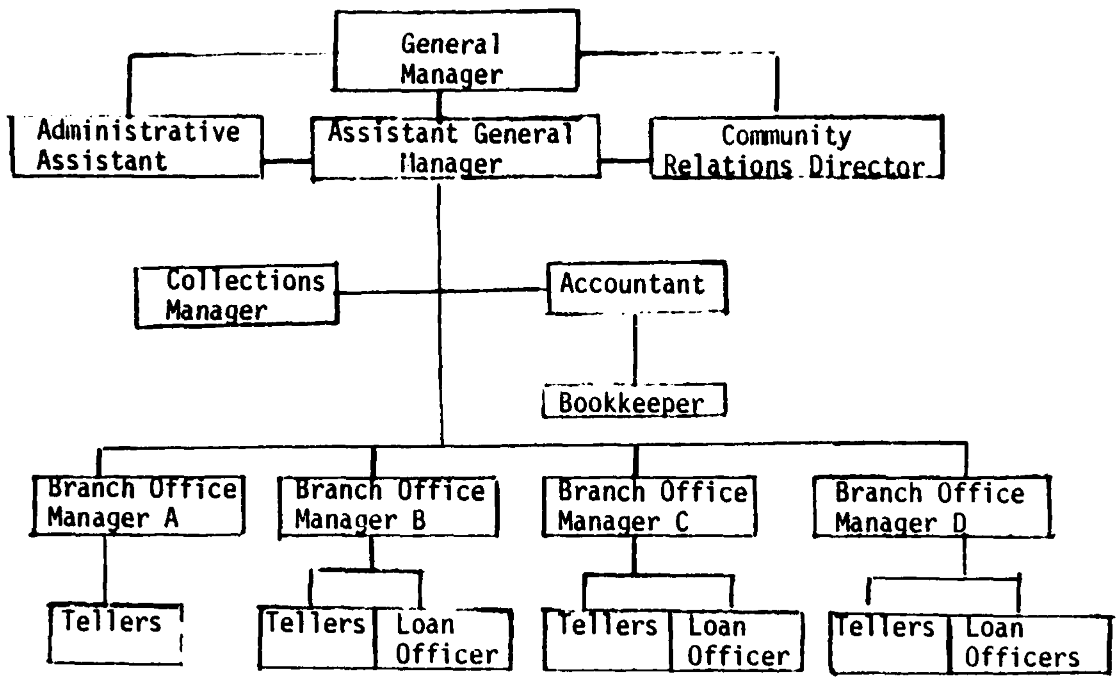
5. Results Achieved from the 12 February Interview [22: A-2.1.1].

a. Organizational Structure

Exhibit VI-1 presents the organizational structure of the cooperative reviewed. As indicated in the exhibit, the General Manager does have an Administrative Assistant, but the cooperative did not have a job description for the Administrative Assistant or a formally established personnel department. The normal functions of a personnel department or of an Administrative Assistant were accomplished by several management officials. For example, the Administrative Assistant's primary duties were to maintain personnel files and also to serve as the personal secretary for the General Manager. Recruiting functions were conducted by the Assistant General Manager by contacting local employment agencies and running want-ads in newspapers. Hiring of employees was undertaken by the Assistant General Manager and the General Manager. However, the General Manager retained final approval to hire personnel. The Community Relations Director was responsible for the cooperative's orientation program and the Branch Managers were responsible for the training of employees. The audit team determined that even though each of these management officials was involved and performed administrative

EXHIBIT V-1

ORGANIZATIONAL STRUCTURE CHART



functions, they were not formally assigned these duties. Further, the cooperative had not formally established programs for any of these areas.

b. Job Descriptions

In review of the cooperative's job classification system, the audit team ascertained that most major positions had job descriptions and that many of the actual duties performed by employees were included in the position description. Job descriptions were also utilized for applicants to review during interviews and when applying for jobs.

c. Employee Performance Evaluations

Standardized employee performance evaluations were utilized by the cooperative to review the performance of all employees. New employees' progress reports were required to be completed by Branch Managers at 30 day intervals and forwarded to the central office. Additionally, Branch Managers were required to counsel employees on their reports and both the manager and the employee signed the evaluation. At the central office, the evaluations were reviewed by the Administrative Assistant and filed in the appropriate personnel folder. Tenured employees were supposed to have annual evaluations of their performance, however, the audit team discovered that this policy was not normally followed.

d. Wage Scale

The wage scale for employees of the cooperative incorporated various grades one through 12 and one through six for merit increases. However, the salaries were not included in the job classifications and the actual wage scale was not made available to employees.

Fringe benefits to employees included two week paid vacations, paid holidays, and annual sick leave. Medical and group life insurance was also available through the cooperative at no cost to employees. Additionally, if employees traveled outside local credit union offices on official business, they were fully reimbursed for all expenses. Employees were also provided with a retirement plan where the cooperative contributed an amount equal to ten percent of an employee's annual earnings to the employee's retirement fund.

e. Personnel Turnover

A review of personnel attrited in 1980, revealed that eight employees were terminated by management officials and a total of 16 were attrited for the year. This attrition occurred from 22 full-time positions and four part-time positions. Further, it was determined that 15 of the employees attrited were clerks/tellers and only one employee was a loan officer. Nine of the attrited employees had worked in Branch Office A, four in Branch Office B, two in Branch Office C, and one in Branch Office D. Analysis of the

distribution of positions indicated that Branch Office A had nine positions of which six were tellers/clerks, Branch Office B had four positions of which three were tellers/clerks, Branch Office C had four positions of which two were teller/clerks, and Branch Office D had nine positions of which one was a teller/clerk.

6. Results Achieved from the 2 March Interview [22: A-3.1.1]

a. Interview Process

In review of the interview process, the audit team determined that the Assistant General Manager is normally the first management official to interview applicants seeking employment. Further, during the course of the interview with the applicant the Assistant General Manager reviews the application form and evaluates the applicants qualifications for the desired position. The Assistant General Manager estimated that the inverview takes approximately 20 minutes. Additionally, he indicated that no general guide for questions to ask the applicant has been developed. Interviews are also conducted with the General Manager and the Branch Manager where the applicant will work.

b. Recruiting Costs

The Assistant General Manager informed the auditors that recruiting costs paid by the cooperative amount to approximately 15 dollars a quarter to "run" want-ads.

c. Training Costs

Since no certralized training is conducted and training of new employees is accomplished "on the job" by utilizing existing employees, the Assistant General Manager made the following estimates.

(1) One weeks pay without being effective for tellers/clerks without experience.

(2) Two to three days pay for tellers/clerks with experience.

7. <u>Conclusion</u>

ased on the evidence and background information obtained as a reault of the preliminary survey, a detailed examination of the cooperative's personnel function proceeded on the basis of the following tentative audit objective [22: A-4.5].

Criteria . . . . . . Has the recent rapid growth of the cooperative coupled with the lack of formally established programs in recruiting, hiring, and training employees . . . .

Cause. . . . . resulted in the high rate of clerk/teller turnover experienced in calendar year 1980. .

Effects. . . . . . . thereby, increasing personnel costs to the entity and reducing overall efficiency of employees in rendering services to members of the cooperative. .

D. SUMMARY REPORT OF THE DETAILED EXAMINATION [22: B-9.11]

1. Objective of the Detailed Examination

The objective established for the detailed examination was to obtain sufficient, competent, relevant, and material evidence on the tentative audit objective identified in the preliminary survey phase. The auditors also concluded that evidence would have to be compiled as to the:

a. Acceptability of the criteria for the tentative audit objective.

b. Specific action or lack of action within or outside the cooperative which caused the effects delineated in the tentative audit objective.

c. Significance of the effects on the cooperative's operations and membership.

2. Work Performed [22: B-9.1]

To guide the audit team in the detailed examination effort, the audit program developed for personnel in the "single audit" guide for Chapter V was utilized. Additional questions were developed and tailored to the specific cooperative reviewed and are provided herein as Appendix B. The audit program was executed primarily through interviews conducted with key cooperative personnel as follows:

Date	Person Interviewed
2 March 1981	Attrited Cooperative Employee
5 March 1981	Branch Manager of Branch Office C
	Branch Office C Employee
10 March 1981	Attrited Cooperative Employee

Date	Person Interviewed
12 March 1981	Branch Manager of Branch Office B Branch Office B Employees
13 March 1981	Community Relations Director Administrative Assistant
16 March 1981	Branch Manager of Branch Office A Head Teller Branch Office A
17 March 1981	Operations Officer of another local cooperative

3. Results Achieved [2[illegible]: B-9.2]

a. Findings of Preferred Practices

(1) Employee Compensation. Wages and fringe benefits received by the cooperative's employees are more favorable than those of other cooperatives in the general geographical area.

(2) Personnel Policies. Established personnel policies are excellent working documents and provide an outstanding base for incorporating many of the audit finding recommendations.

(3) Procedures Manual. The procedures manual is extremely adequate and clearly assists employees in performing their designated duties and responsibilities.

(4) Employee Performance Evaluation. New employee performance evaluations are adequate and are utilized by all management officials.

b. Major Deficiency Findings

(1) Personnel Structure. A formally established personnel department has not been designated and the duties and responsibilities of the personnel director are not formally assigned.

(i) Preferred Practice. The personnel function must have a defined organizational structure. Normally, the personnel function is headed by a personnel director or officer who reports to the chief executive.

(ii) Effect. The absence of a formally designated personnel director makes it impossible to establish accountability for personnel functions.

(iii) Recommendation. The duties and responsibilities of a personnel director should be formally assigned to a single individual.

(2) Personnel Policies. Established personnel policies do not include the state requirement that each employee receive a ten minute break during each four hours of labor.

(i) Preferred Practice. Applicable laws, regulations and union contracts must be adhered to by each operating entity to foster adequate morale and to avoid potential unfair labor practice violations.

(ii) Effect. Employees have worked six hours straight without receiving a break from designated duties and responsibilities.

(iii) Recommendation. Amend personnel policies to include the California requirement for breaks and ensure all management officials require employees to take the regular breaks.

(3) <u>Employee Lunch Breaks</u>. Established personnel policies for lunch are not being followed.

(i) Preferred Practice. Cooperative personnel policies stipulate that lunch time for all employees will be 45 minutes.

(ii) Effect. Employees recieve ten to 60 minute lunch breaks at various Branch Offices.

(iii) Recommendation. Ensure all management officials are aware of the stipulated time allowed for employees to eat lunch. Further, the Personnel Director should routinely ascertain compliance with established policies.

(4) <u>Normal Work Day</u>. Established policies for the commencement of the normal work day are not followed.

(i) Preferred Practice. Cooperative personnel policies stipulate that the work day begins at eight a.m.

(ii) Effect. Employees are required to arrive for work ten to 15 minutes prior to designated work hours to set up teller's counters and they do not receive salary or compensatory time off. If this practice continues the cooperative could be subject to an unfair labor practice violation.

(iii) Recommendation. That all management officials require employees to work only those hours for which they receive salary. Further, instruct employees to notify the Personnel Director if violations occur.

(5) Overtime. Established personnel policies for overtime or granting compensatory time off are not followed.

(i) Preferred Practice. Cooperative personnel policies stipulate that the standard work day is eight hours and the standard work week is 40 hours. Further, after an employee works these standard hours they are authorized overtime or compensatory time off.

(ii) Effect. Employees are required to remain at work past standard work hours and receive neither overtime nor compensatory time off. If this practice continues the cooperative could be subject to an unfair labor practice violation.

(iii) Recommendation. That all management officials document extra hours employees work and ensure they receive overtime or compensatory time off. Further, only one management official should be authorized to approve overtime worked by employees.

(6) Personnel Pools. Personnel pools are not utilized for seasonal, emergency, and temporary assignments.

(i) Preferred Practice. Personnel pools reduce the burden placed on employees when a member of the

staff must be away from the entity and reduces the requirement for overtime or compensatory time off.

(ii) Effect. Employees are required to "take up the slack" when a member of the staff must be out of the office, thus requiring employees to arrive early and remain past standard working hours.

(iii) Recommendation. Establish a personnel pool for "on-call" clerks/tellers to assist the entity when an employee must be out of the various branch offices.

(7) Filling Personnel Needs. No formally established recruiting/hiring program exists.

(i) Preferred Practice. An effective recruiting system must exist to ensure that adequate numbers of qualified employees are available when needed.

(ii) Effect. Due to the lack of formally established hiring standards, some employees hired are over qualified or qualified for other professions and seek short term employment with the cooperative.

(iii) Recommendation. Formally establish hiring standards and encourage present employees to actively recruit qualified applicants. Further, if an employee does recruit an applicant and the applicant is hired, the employee should be given a reward of some type.

(8) Communication. Employees do not receive timely information on newly established policies or procedures of the cooperative.

(i) Preferred Practice. For an organization to function efficiently and make a maximum contribution toward the achievement of an entity's objectives a clear line of communication must be made available.

(ii) Effect. Established operating policies have been changed and employees were not aware of the change until observed on the computer terminal.

(iii) Recommendation. Publication of either a monthly or quarterly employee's news letter that discusses or stipulates new policies, when they will commence, and other general information important to the employees duties.

(9) Training. A completely documented training program does not exist and several undesignated employees conduct training functions without an officially approved training schedule.

(i) Preferred Practice. No organization can afford to ignore the educational and career development needs of its employees if it is to maintain the level of competence required for effective and efficient operations.

(ii) Effects. Standardized training procedures are not utilized by Branch offices and there is no system to evaluate training needs.

(iii) Recommendation. Establish a documented training program and formally designate a single employee to

be responsible for ensuring that training is conducted within responsible guidelines. Further, conduct an analysis of the training needs of the entity and develop a system to determine the effectiveness of the training program.

c. Minor Deficiency Findings

(1) Position Descriptions. Position descriptions have not been developed for all positions in the cooperative.

(i) Preferred Practice. Basic requirements for a satisfactory personnel structure include position description for all employees.

(ii) Effect. Position descriptions for the Administrative Assistant and Bookkeeper have not been constructed, therefore accountability cannot be established.

(iii) Recommendation. Establish position descriptions for all employee positions within the cooperative.

(2) Position Descriptions. Existing position descriptions have not been reviewed in the last 18 months.

(i) Preferred Practice. Position descriptions should be reviewed periodically and updated to be responsive to the plans and policies of top management.

(ii) Effect. Position descriptions for the loan processing clerk and clerk/teller positions stipulate they are directly responsible to the Branch Manager of Branch Office C.

(iii) Recommendation. Update and review all existing position descriptions and require the personnel

department to review each position description at least annually.

(3) Awards Program. The cooperative does not have a formally established awards program to recognize superiper performance of employees.

(i) Preferred Practice. Employees whose performance is outstanding should receive official recognition from management.

(ii) Employees feel that management does not recognize a job well done and employees morale is therefore lowered.

(iii) Recommendation. Establish a formal program that recognizes employees who exhibit outstanding performances.

E. MANAGEMENT LETTER

On 19 March 1981, the above findings of preferred practices and deficiency findings were reviewed by the cooperative's management staff and with their concurrence, a formal letter was issued containing these findings, together with a statement of the audit team's [illegible] as follows: [22: D-3.1].

> "Based on the results of the review, the audit team is of the opinion that the personnel policies and procedures are basically sound. However, the established personnel policies and procedures should be streamlined to reflect incorporation of a formal personnel department which would be responsible for the following:
>
> 1. Incorporating all documents concerning personnel into a single manual or volumes of manuals.
> 2. Formalizing unwritten policies and procedures.

3. Determining the content and order of all personnel files.

4. Establishing an employee's newsletter that includes subjects such as position openings, changes to exist- policies or procedures, social events, contributions of outstanding employees, and educational opportunities.

5. Developing an incentive/award program to recognize outstanding employess.

6. Establishing formal hiring standards for all cooperative positions.

7. Reviewing position descriptions and salary scales for appropriateness at least annually.

8. Organizing a program for formal training of employee. This could include California Credit Union League Seminars and/or locally prepared lectures.

9. Reviewing all performance evaluations on all employees, and taking timely and effective acti-n to ensure that possible employee motivational problems are corrected before major personnel conflicts arise.

It is the opinion of the audit team that personnel turnover will continue at its present high rate unless responsibility and accountability for the personnel function are focused on a single individual who is able to devote a major portion of his/her time to establishing and maintaining an active personnel department. It is believed that if the recommendations of the audit are adopted the cooperative could reduce the 6000 dollars a year now spent on training costs. Further, this figure does not include the savings that would develop from obtaining a work force whose level of knowledge and efficiency is increased through reductions in personnel turnover or the interview time of management officials."

F. SUMMARY

This chapter presented a management audit on the personnel function of a typical cooperative. The scope of the audit was explained as well as summary reports for the preliminary survey and the detailed examination. The chapter also validated the basic soundness, flexibility, and usefulness of the personnel subprogram of the "single audit" model developed in Chapter V and demonstrated the applicability of such a model.

The next chapter presents the conclusions and recommendations of the author developed from this research study.

VII. SUMMARY AND CONCLUSIONS

A. SUMMARY

Initially, the reader was introduced to the organizational structure, services provided, and the basic management operations of a Federal credit union. It was pointed out that the National Credit Union Administration (NCUA) has established preferred practices and regulations that management officials of a cooperative should comply with in its overall management function. The research study then explained the primary purpose of an internal audit body, such as the supervisory committee, in evaluating managements performance in complying with preferred practices or regulations. Additionally, it was explained that the internal audit task must go behind the figures shown on financial statements to verify the actual conditions of the credit union, and identify functional areas where effectiveness or efficiency can be improved.

A survey was then taken of Federal credit union managers concerning internal and external auditing of their respective cooperatives and their perceived need for a "single audit" program. Eighty-nine percent of the respondents indicated that a "single audit" program for key areas in the credit union would be beneficial. Further, 59 percent of the general managers indicated that such a program would make

the internal audit function more effective. The author then developed a "single audit" model that included audit subprograms for fiscal administration, property management, procurement, personnel, and operational activities for Federal credit unions. Each subprogram was discussed and key control aspects for the audit body to verify were explained. The author then evaluated the existing personnel function of a representative cooperative by using the personnel subprogram of the "single audit" model. In reporting the results of the audit the scope of the review was defined as well as the objective of each audit phase, work performed, and results achieved.

The concluding paragraphs will summarize the general conclusions of the author and outline those areas considered appropriate for future study.

B. CONCLUSIONS

1. The auditing function of Federal credit unions is conducted almost exclusively by external auditors. The supervisory committee typically makes the necessary arrangements to hire a certified accounting firm to conduct an annual audit, but the committee does not perform the normal role of an internal auditing body. This condition exists due to the lack of auditing expertise among committee members and the lack of audit programs that include preferred practices.

2. Annual audits conducted are primarily restricted to financial and compliance areas. Since most cooperatives utilize certified public accounting firms to perform annual audits, functional areas for improved efficiency or effectiveness are not reviewed. The partial management audit performed by the author revealed that the personnel function of the cooperative had not been reviewed in the numerous annual audits the entity had received in past years.

3. Duplicative and repetitious audits are conducted. In calendar year 1980, respodents to the survey indicated 128 audits were completed for an average of four per cooperative. This coupled with the fact that most audits performed are in the financial and compliance area confirms that efforts, time, and funds are not being effectively and efficiently utilized.

4. Development of a "single audit" program for a particular entity is not beyond the capability of even small cooperatives. The multipurpose audit program developed in Chapter V provides the basic framework within which a "tailored" audit guide for a particular cooperative can be outlined with little or no outside assistance required.

5. A "single audit" guide provides an auditing body flexibility in executing the audit function. With a multipurpose audit program constructed of separate subprograms for key areas, the auditing body can perform a complete review of all functional areas or select individual tasks to audit.

6. A "single audit" program would be beneficial to various auditing bodies. As indicated in the results from the questionnaire in Chapter 4, the audit guide would be beneficial to the supervisory committee, management officials, and external Federal credit union auditors in evaluating the operations of the cooperative.

7. A "single audit" program for Federal credit unions is desired and needed. The current audit guide provided by NCUA for the annual audit does not include many preferred practices of NCUA or of other authorities. As a result, many cooperatives do not have an effective internal review "tool" and may not be capable of identifying and eliminating costly, nonessential activities to reduce increasing operational costs.

8. Effective utilization of the "single audit" model may require training. Publishing the audit guide by NCUA will not necessarily ensure a more active and beneficial internal auditing body. NCUA should consider holding training seminars at regional offices that include mock reviews using the multipurpose guide to develop tailored audit programs. This training and practical application of the model would acquaint committee members with audit techniques for effective utilization of the guide as well as the overall role of an internal auditor.

9. The internal audit role of the supervisory committee must be elevated. To overcome the present deficiencies of

the internal review function, management officials, boards of directors, and NCUA must stress the importance of the function and the benefits derived therein. Methods should be developed to provide recognition and status for members assigned to the committee. NCUA might consider authorizing compensation to members who serve on the committee. Payment to these members for auditing services could be easily offset by more effective and efficient use of cooperative resources as well as possibly attracting more qualified members.

C AREAS FOR FUTURE STUDY AND RECOMMENDATIONS

1. Technical Expertise

While recognizing that small cooperatives will lack members who have adequate auditing and accounting experience to utilize an audit program, even after training, this problem could be minimized by developing centralized audit teams from several cooperatives, or as an alternative, possibley several cooperatives placing a single management firm on retainer to audit the performance of management.

2. Test and Evaluation

Since the author of this research study was unable to effectively test and evaluate the complete "single audit" model, it is recommended that NCUA review the model and select various cooperatives to test the model and evaluate its completeness and usefulness. Testing the model in this manner

would indicate whether it will enhance the total internal audit function of Federal credit unions.

The objectives of this study were to evaluate the internal audit function of cooperatives and to explore the potential benefit of a "single audit" program for Federal credit unions. In summary, the conclusions and recommendations provided herein, support the need for an improved audit function within the realm of credit unions. A "single audit" approach is one possible answer.

APPENDIX A

AUDITING QUESTIONNAIRE ON INTERNAL AND EXTERNAL AUDITING OF FEDERAL CREDIT UNIONS

1. Asset base:__________ Number of Members:__________

	Yes	No
2. Does the credit union receive annual audits?	____	____
a. Is this auditing conducted by external auditors?	____	____
b. Is this auditing conducted in financial and compliance areas?	____	____
c. Is auditing conducted internally by:		
Management Officials	____	____
Supervisory Committee	____	____
Other (Please specify)__________		
3. Is auditing conducted annually on functioning systems, controls, procedures, and practices?	____	____
a. Is this auditing conducted by external auditors?	____	____
b. Is this auditing conducted by the supervisory committee?	____	____
c, Is this auditing conducted by other sources? (Please specify)__________.	____	____
d. Does this auditing include efficiency and economy audits?	____	____
e. Does this auditing include program results audits?	____	____
4. Does the supervisory committee perform annual audits other than verifying each members share and loan balances? If yes, please define key areas audited.__________.	____	____

	Yes	No
a. Does the supervisory committee perform annual audits to verify each members share and loan balance?	___	___
b. Are audit tasks of the supervisory committee guided by programs, objectives, or audit guides?	___	___
c. Do other auditing agencies have audit programs, objectives, or audit guides for audit tasks?	___	___
d. Are internal audit programs, objectives, and/or audit guides revised to reflect changing conditions?	___	___

5. Average experience in auditing of members on the supervisory committee is __________ years.

a. Is this experience formal training in auditing?	___	___
b. Is this experience on the job training in auditing?	___	___

c. Other (Please specify) ______________________________

____.

d. Do you consider this experience level adequate to perform audit work in the credit union?	___	___

6. Would a single audit program for key areas in the credit union be beneficial?	___	___
a. To the supervisory committee?	___	___
b. To management officials?	___	___
c. To external audit body?	___	___

	Yes	No
d. Would a single audit program reduce multiple visits to the credit union by the audit agency, thereby saving time and money to the credit union?	____	____
7. Do you feel that the supervisory committee of your credit union is an active internal auditing body?	____	____
8. Would a single audit program for key areas make the supervisory committee a more active and beneficial internal auditing body?	____	____
9. Is there a need for auditing of systems, controls, procedures, and practices in your credit union?	____	____
a. Need for economy and efficiency audits?	____	____
b. Need for program results audits?	____	____
10. Are internal audit activities directed toward audit assignments, rather than clerical tasks?	____	____

11. In calendar year 1980, this credit union received an audit in:

	NUMBER
a. Financial and compliance areas	____
b. Economy and efficiency areas	____
c. Program result area	____
d. Members share and loan balance area	____
e. Other areas	____

(Please specify) ______________________________.

APPENDIX B

ADDITIONAL QUESTIONS FOR PERSONNEL AUDIT PROGRAM

A. Questions Directed at Branch Managers

1. What are the minimum hiring standards at the cooperative?

2. What attributes do you desire in a prospective employee?

3. Do you feel that prospective employees should take a standardized test to determine their skill level?

4. What activities is a new employee engaged in during the first week?

5. What percentage of effectiveness does a new employee attain during the first two weeks?

6. How long does it take an employee to become 100% effective?

7. Is there a need for centralized training of new employees?

8. Do you keep written records on employee absences, illnesses, chronic lateness, or full work days not worked?

9. How does the cooperative overtime/compensatory time off work at your branch?

10. What procedure do you follow for giving employees breaks?

11. How do you coordinate employee lunch breaks?

12. How long are breaks and how long are the lunch breaks?

13. How are vacations scheduled?

14. How is the extra work created by an absent employee (excused or unexcused, or vacation) handled at your branch?

15. Is there any formalized procedure for employees to make suggestions to management?

16. Is there any reward or incentive program to recognize outstanding employees?

17. Is there a need for a formalized reward/incentive/recognition program for outstanding employees?

18. What are the hours of a work day for a full time employee?

19. Are employees ever required to be present before the work day begins and/or after the workday ends without sufficient or any compensation?

20. Do you feel that policy changes are communicated in a timely and effective manner?

21. Do you use the employee performance evaluations (both 90-day and annual) as delineated in the cooperative personnel policy and benefits book?

22. Do you have a copy of the cooperative personnel policy and benefits book? (The Blue Book)

23. Do you use the book and is it available to all employees?

24. Do you have a copy of the procedures manual?

25. Is the procedures manual a worthwhile document?

26. Do you have a copy of employee job descriptions and salary ranges?

27. In your opinion what changes could be made to reduce employee turnover?

28. What do you need as a manager to make your branch more efficient?

B. Questions for Employees

1. How do you rate the salary and benefits package at the cooperative?

2. Is overtime or compensatory time off granted at your Branch? If so how?

3. How are breaks and lunch breaks handled at your Branch?

4. Do you feel that the training you received as a new employee was sufficient to become an effective employee?

5. How long did you have to work as a trainee with either you watching an experienced employee or an experienced employee watching you?

6. What changes should be made at the cooperative to reduce personnel turnover?

7. Do you feel that policy changes are communicated in a timely and effective manner?

8. Do you desire to make your job at the cooperative a career?

9. Do you feel that there is sufficient room for advancement at the cooperative?

10. Do you think a suggestion box would be a morale booster for employees?

11. Do you feel performance evaluations are fair and are used fairly?

12. Do you feel that the cooperative has an effective communication system for employees? (position availabilities, compamy news, social events)

13. Are you aware of the cooperatives outside education program?

14. Do you feel company sponsored outside education is necessary?

15. Is there a need for centralized and regular training on subjects such as; What to do in an emergency, telephone procedures, and how to implement changes in the cooperative's policies?

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